Supreme Court, U.S.
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No. ____

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

MYRNA RODRIGUEZ, JUAN E. LUGO, *et al.*,
Petitioners,

v.

SECRETARY OF THE TREASURY OF THE COMMONWEALTH OF PUERTO RICO, *et al.*,
Respondent.

Petition for Writ of Certiorari to the Supreme Court of Puerto Rico

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PETITION FOR WRIT OF CERTIORARI

ROBERT G. MULLENDORE
Counsel of Record
WILLIAM C. WATT
MULLENDORE, TAWNEY & WATT, P.C.
310 West Spruce
Missoula, Montana 59802
(406) 542-5000
Counsel for Petitioners

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

Whether federal law granting the cost-of-living allowance ("COLA") to federal civilian employees in Puerto Rico and exempting the COLA from federal income tax pre-empts the Commonwealth of Puerto Rico from imposing its own similar income tax on the COLA.

Whether the COLA is a noncompensatory allowance for which the United States has not given its consent to taxation by Puerto Rico pursuant to the Public Salary Tax Act, 4 U.S.C. § 111.

PARTIES BELOW *

Plaintiffs-Appellants:

> Myrna Rodriguez, Juan E. Lugo, Hector Arana, Juan N. Sanchez José Rolden, José Rodriguez, Jr., Elba G. De Picon, Zayda Hernandez, Floyd Olson, Shirley J. Suarez, Reinaldo Garcia-Cruz, Marshall D. Burgess, Ruben D. Vazquez, Harold E. Hopkins, Jr., Adolfo Mariani, José Ramos-Ortiz, Santos Mercado, Eugene Parker, and Carmen R. Alfonso-Sanchez, for themselves and on behalf of all others similarly situated, and COLA Defense Committee of Puerto Rico, Inc.

The plaintiff class certified by the Superior Court of Puerto Rico is described as follows:

> "All persons employed within the Commonweaith of Puerto Rico at any time on or after January 10, 1979, by the United States or any agency, establishment, or instrumentality thereof, or a corporation owned by the United States including but not limited to the United States Postal Service, who are or were entitled to receive a cost-of-living allowance, or a like payment as part of basic pay, by or in accordance with 5 U.S.C. section 5941.201-.213 (sic), and/or Executive Order 10,000, as amended, or pursuant to another statute, regulation, administrative practice or contract".

Defendant-Appellee:

> Secretary of the Treasury of the Commonwealth of Puerto Rico.

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* Pursuant to Rule 29.1, the named corporate petitioner states that it does not have any parent or subsidiary companies. The non-profit COLA Defense Committee of Puerto Rico, Inc., was formed pursuant to the order of the U.S. Claims Court in *Karamatsu v. United States*, No. 224-85C (Cl. Ct. Dec. 19, 1985).

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OPINIONS BELOW

The opinion of the Supreme Court of Puerto Rico is reported as *Rodriguez v. Secretario de Hacienda*, 94 JTS 20 (1994). The opinion of the Superior Court, San Juan Part (App. B), has not been reported in any official or unofficial reports. The Appendix sets forth certified translations of these opinions prepared by the court interpreter for the U.S. District Court for the District of Puerto Rico.

JURISDICTION

The judgment of the Supreme Court of Puerto Rico was entered on March 1, 1994 (App. 1a, 49a). This Court has jurisdiction under 28 U.S.C. § 1258.

STATUTES AND REGULATIONS INVOLVED

U.S. CONST. art. VI, cl. 2 (App. 50a).

4 U.S.C. § 111 (1988) (App. 50a).

5 U.S.C. § 5941 (1988) (App. 50a).

26 U.S.C. § 912(2) (1988) (App. 51a).

P.R. Laws Ann. tit. 13, § 3022(a) (1954) (App. 51a).

STATEMENT OF THE CASE

A. Nature of the Case

This case concerns the imposition of Puerto Rico's income tax on the federal cost-of-living allowance ("COLA") received by nearly 10,000 federal civilian employees who work in Puerto Rico. Petitioners contend that federal law creating the COLA program and exempting it from federal income tax bars the imposition of Puerto Rico's unique federal-style income tax on this noncompensatory allowance. Subjecting the COLA to Puerto Rico's income tax causes at lease the same diminution in the utility of the COLA as Congress intended to prevent by exempting it from federal income tax.

The federal questions sought to be reviewed were raised in the plaintiffs' initial class-action tax refund complaint filed in this case, which expressly asserted that federal law bars the imposition of Puerto Rico income tax on the COLA on the following grounds: (1) that the Secretary's taxation of the COLA unconstitutionally interferes with the purpose of the COLA program in violation of the Supremacy Clause (Complaint ¶ 4.1.4); (2) that the COLA is not "pay or compensation" as defined in the Public Salary Tax Act, 4 U.S.C. § 111, and the United States has not consented to its taxation by Puerto Rico (Complaint ¶ 4.1.5); and (3) that the Secretary's taxation of the COLA is discriminatory against members of the plaintiff class, in violation of 4 U.S.C. § 111 (Complaint ¶ 4.1.6).

These same questions of federal law were raised in the parties' cross-motions for summary judgment. In its opinion granting summary judgment in favor of the Secretary, the Superior Court set forth these federal law questions as the issues to be decided (App. 31a), holding that: (1) it need not apply the Supremacy Clause, because no specific provision of federal law forbids Puerto Rico's taxation of the COLA, expressly or otherwise (App. 39a); (2) as an addition to basic pay, the COLA constitutes "compensation" subject to taxation by Puerto Rico under 4 U.S.C. § 111 (App. 40a); and (3) that no question of fact precluded summary judgment on the issue of whether any exemptions recognized by Puerto Rico for quarters and subsistence allowances received by members of the Puerto Rico National Guard constituted discriminatory taxation of federal civilian employees' COLA (App. 45a).

These federal questions were again raised as specifications of error on appeal to the Supreme Court of Puerto Rico (App. 2a, n.3) and affirmed in all respects (App. 9a). In the majority opinion, the Supreme Court of Puerto Rico held that (1) the federal statute granting the COLA is silent on state or territorial taxation (App. 7a); whereas (2) the Public Salary Tax Act authorizes Puerto Rico's taxation of these allowances as "compensation additional to the basic wage" (App. 5a); and (3) the federal employees failed to prove that taxation of the COLA was discriminatory as to similarly situated persons (App. 5a).

Petitioners pray that a writ of certiorari be issued to review the judgment of the Supreme Court of Puerto Rico on these important questions of federal law which affect a large part of the federal workforce in Puerto Rico.

B. Statement of Facts

Pursuant to federal law, federal employees in Puerto Rico receive an allowance based on "living costs sub-

stantially higher than in the District of Columbia." 5 U.S.C. § 5941(a)(1) (App. 50a). This cost-of-living allowance, or "COLA", is computed by the Office of Personnel Management according to detailed surveys and economic analyses measuring differences in living costs between the Washington, D.C., area and the specific areas in which federal employees are eligible to receive the COLA. *See, e.g.,* 58 Fed. Reg. 45,556-45,651 (1993).

Based on analyses of these elaborate cost-of-living surveys, the Office of Personnel Management establishes COLA rates which are expressed as a percentage of base pay. 59 Fed. Reg. 13,844, 13,850 (1994). The Office of Personnel Management does not take income taxes into account in setting COLA rates. 59 Fed. Reg. 13,844, 13,845. At all times pertinent to this case, the COLA received by federal employees in Puerto Rico has been equal to ten percent (10%) of the employees' base pay.

The COLA is excluded from gross income and exempt from federal income taxes under 26 U.S.C. § 912(2) (App. 51a). The legislative history of the COLA tax exemption clearly indicates that Congress intended the COLA to better enable federal employees to carry out their official assignments, and to be "noncompensatory in character" as distinguished from other types of allowances or recruitment incentives. Rev. Rul. 59-407, 1959-2 C.B. 19, 20.

Despite the non-compensatory character of the COLA, the Secretary of the Treasury of the Commonwealth of Puerto Rico (hereinafter, the "Secretary") has taken the position that the COLA is subject to Puerto Rico's income tax. The Secretary's position is based solely on Puerto Rico's general income tax statute defining "gross income," and the absence of any express exclusion or exemption for the federal COLA. App. 14a, 33a; P.R. Laws Ann. tit. 13, § 3022(a) (App. 51a).

The Puerto Rico income tax system is similar to the federal income tax system, but unique among the other States, territories and possessions of the United States. Puerto Rico's income tax rates have generally been equal to or higher than federal income tax rates. For example, throughout the period 1979-1987, the marginal tax rate on individual taxable net income above $22,000 (married filing jointly) *exceeded forty percent (40%)*. P.R. Laws Ann. tit. 13, § 3011. Similar to the 1986 changes in the federal income tax rate structure, Puerto Rico's 1987 tax reform act generally lowered individual income tax rates and reduced the number of brackets. The current individual rates are 25% for taxable net income above $15,000, and 33% above $30,000. *Id.*

The interplay between Puerto Rican and federal income taxes also demonstrates the unique national character of Puerto Rico's income tax. Among bona fide Puerto Rico residents, only federal employees are subject to both federal and Puerto Rico income tax on their employment earnings in Puerto Rico. 26 U.S.C. § 933(1). To prevent double taxation, federal employees receive a credit against their federal tax liability, in the same manner as credits for taxes paid to a foreign country. 26 U.S.C. § 901. However, since the COLA is not subject to federal income tax, federal employees' payments of Puerto Rico income tax on the COLA may not be credited against federal income tax liability. 26 U.S.C. § 904.

No other COLA area has such a tax system. The Virgin Islands' income tax system mirrors the federal income tax, and the COLA is thus exempt from taxation according to federal law. *See* 48 U.S.C. § 1397. The same is essentially true for Guam. *See* 48 U.S.C. § 1421i. Alaska does not currently levy a state income tax on its residents. Among the COLA areas, Hawaii is the only other jurisdiction that imposes its income tax on the COLA. Haw. Rev. Stat. § 235-7(b). However, Hawaii's income tax rates are only a fraction of Puerto Rico's,

Haw. Rev. Stat. § 235-51, and the propriety of Hawaii's taxation of the COLA has never been litigated.

Thus, Puerto Rico's tax system has the character of a national income tax, and is essentially equivalent to the federal income tax from which Congress has expressly exempted the COLA. By diminishing the COLA from 25-40% for federal employees with only modest income, Puerto Rico's income tax has nullified the effectiveness of the COLA program in precisely the same manner (and to an even greater extent) as Congress sought to prevent when it exempted the COLA from federal income taxes.

C. Course of Proceedings

The long and tortuous proceedings in this case began in April of 1985, when the petitioners' counsel of record filed a claim with the Secretary on behalf of all federal employees in Puerto Rico seeking refunds of Puerto Rico income taxes paid on the COLA. In subsequent discussions, the treasury department maintained that the COLA was taxable, but the Secretary declined to issue a formal denial of the claim, a prerequisite for litigating tax refund claims in the courts of Puerto Rico. P.R. Laws Ann. tit. 13, § 3323.

Because the Secretary's inaction barred them from proceeding in the Commonwealth courts, and in view of the strong federal interests involved, the federal employees in 1987 filed a class action complaint in the U.S. District Court for the District of Puerto Rico. The district court dismissed the case for lack of subject matter jurisdiction under the Butler Act, 48 U.S.C. § 872. *Parker v. Agosto-Alicea*, Civ. No. 87-0386 (PG) (D. Puerto Rico) (Opinion and Order Feb. 4, 1988).

It was only after oral argument on appeal, when the panel pressed the Secretary's counsel on the question, that the Secretary formally issued a denial of the COLA tax refund claim pursuant to Puerto Rico law in his letter

dated May 10, 1989. *Parker v. Agosto-Alicea,* 878 F.2d 557, 559 (1st Cir. 1989). Since the federal employees were then able to pursue their remedies in the Commonwealth courts, the First Circuit affirmed dismissal for lack of jurisdiction. *Id.* at 560.

Following receipt of the Secretary's refund claim denial, the federal employees timely filed their class-action income tax refund complaint in this case in the Superior Court, San Juan Part, on June 9, 1989, pursuant to P.R. Laws Ann. tit. 13, § 3323. As a protective measure, the federal employees also filed an action seeking judicial review under the recently enacted Puerto Rico Administrative Procedure Act. *Lugo v. Secretary of the Treasury*, No. KAC89-0931 (906) (Superior Ct., San Juan Part).

Before proceedings got underway in either case, however, the Superior Court, *sua sponte*, dismissed this case in favor of the APA review procedure in the *Lugo* case on August 9, 1989. The federal employees appealed to the Supreme Court of Puerto Rico, while the Superior Court stayed proceedings in this case pending resolution of the fundamental question of the proper judicial procedure for income tax refund claims. Finally, more than two years after the complaint was filed in this case, the Puerto Rico Supreme Court reversed the lower court and remanded this case for further proceedings in the Superior Court. *Rodriguez v. Secretary of the Treasury*, RE89-501 (P.R. Supreme Court, June 13, 1991).

Following remand, on September 18, 1991, the Superior Court certified this case as a class action under Rule 20.2(a) and (b) of the Puerto Rico Rules of Civil Procedure, defining the plaintiff class as all federal employees who have received a COLA in Puerto Rico since 1979 (App. 48a). The court also required the plaintiffs to provide notice of the pendency of the class action by publication, and to send personal notice concerning the case to 28,000 past and present federal employees with

Puerto Rico addresses contained in plaintiffs' counsel's computer files from records created in COLA litigation against the United States, all at a cost to the plaintiffs in excess of $11,000.

The plaintiffs in September, 1991, propounded written discovery requests to the Secretary directed primarily at the question of whether the Secretary allowed exemptions of other similar types of allowances for non-federal employees or otherwise discriminated against federal employees in administering Puerto Rico's income tax system. However, with one minor exception, the Secretary failed to answer this discovery, and despite repeated motions by the plaintiffs, the Superior Court declined to compel any responses or deem any matters admitted.

The plaintiffs filed an amended complaint with leave of the court on January 22, 1992. On June 16, 1992, the Secretary filed a pleading styled as an answer to the amended compalint and an amended motion for summary judgment. The motion was supported by an affidavit from David Carrion Baralt averring that he was unaware of any treasury department ruling exempting certain national guard allowances from Puerto Rico income taxes.

When the plaintiffs sought to depose Mr. Carrion-Baralt, the court in its order dated August 19, 1992, canceled the deposition until after it ruled on the summary judgment motion. Thereafter, the federal employees filed their opposition to the Secretary's motion on September 11, 1992, along with a cross-motion for summary judgment on their pre-emption and Public Salary Tax Act claims.

The Superior Court granted the Secretary's motion for summary judgment in all respects on December 17, 1992 (App. 48a). Having prevented the federal employees from deposing the Secretary's only affiant (the only evidence submitted in support of his summary judgment motion), and having declined to require the Secretary to

respond to discovery requests submitted more than a year earlier, the court had no trouble finding an absence of factual issues to preclude summary judgment (App. 43a-47a).

Thus, after almost seven years, and prosecution of appeals to the both First Circuit and the Puerto Rico Supreme Court in order to obtain access to *de novo* review in the Puerto Rico courts, the federal employees' claims were dismissed before trial and without the benefit of discovery. The Supreme Court of Puerto Rico affirmed the Superior Court in all respects in its opinion and judgment entered March 1, 1994 (App. 1a).

ARGUMENT

I. PUERTO RICO'S TAXATION OF THE COST-OF-LIVING ALLOWANCE IS PRE-EMPTED BY FEDERAL LAW BECAUSE IT STANDS AS AN OBSTACLE TO CONGRESS' PURPOSE IN GRANTING THE COLA.

In granting the federal employees an allowance based on the higher cost of living in COLA areas pursuant to 5 U.S.C. § 5941(a)(1), and exempting it from federal income tax pursuant to 26 U.S.C. § 912(2), Congress expressed a clear intent that the COLA not be subjected to diminution by income taxation. Congress intended the allowance for official purposes, in light of higher living costs in the territories, and not as a recruitment incentive or compensation for hostile environmental conditions. As Congress recognized, subjecting the COLA to income taxation either reduces the effectiveness of the COLA to meet official requirements, or necessitates an addition to the COLA to offset the tax, both of which alternatives Congress has rejected.

Imposition of Puerto Rico's income tax on the COLA, at rates exceeding the federal income tax, effectively reduces the COLA in the same manner as Congress sought to prevent by exempting it from federal income taxes,

and stands as a direct obstacle to the full accomplishment of Congress' purpose in granting the COLA. Puerto Rico's taxation of the COLA is therefore pre-empted by federal law. Allowing the Puerto Rico courts' validation of this tax to stand in this case will do violence to Congress' intent, and harm to important federal interests in Puerto Rico.

While acknowledging the unique status of the Commonwealth of Puerto Rico, this Court has held that the federal pre-emption analysis for Puerto Rico is the same as for States under the Supremacy Clause, U.S. Const. Art. VI, cl. 2. *Puerto Rico Consumer Affairs Dept. v. Isla Petroleum Corp.*, 485 U.S. 495, 499 (1988).

The accepted tests for federal-preemption are set out in *Fidelity Federal Savings & Loan Assn. v. de la Cuesta*, 458 U.S. 141 (1982) (federal regulation authorizing due-on-sale clause in federal home loan documents preempts California law). Preemption requires examination of Congressional intent, and may be either express or implied. *Id.* at 152-53. In the absence of explicit language, Congress' intent to pre-empt state law may be inferred when Congress has created a federal regulatory scheme so pervasive as to leave no room for the states to supplement it. *Id.* at 153.

"Even when Congress has not completely displaced state regulation in a specific area, state law is nullified to the extent it actually conflicts with federal law." *Fidelity Federal*, 458 U.S. at 153. As in this case, "[s]uch a conflict arises . . . when state law '*stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress*[.]' " *Id.* at 153, *quoting Hines v. Davidowitz*, 312 U.S. 52, 67 (1941) (emphasis added).

In connection with the latter principle, the *Fidelity Federal* Court also observed that state law deserves no particular deference just because it is an area of "special concern" to the states. *Fidelity Federal*, 458 U.S. at 153

(real property law). This axiom applies equally in this case with regard to Puerto Rico's taxation of the COLA. Petitioners here do not seek to prevent Puerto Rico from collecting its income tax on their base pay and other forms of taxable compensation, nor to avoid paying their fair share of taxes to support the Commonwealth. They seek only to free their 10% COLA from taxation by Puerto Rico, as Congress intended. Any marginal fiscal impact on Puerto Rico is not material to the pre-emption analysis.

Finally, some recent resistance notwithstanding, this Court has long recognized the importance of legislative history in gleaning Congress' intent. *Wisconsin Public Intervenor v. Mortier*, 111 S. Ct. 2476, 2484 n.4 (1991).

The legislative history of the federal tax exemption for the COLA clearly sets forth Congress' purposes and objectives with respect to the COLA. As stated in S. Rep. No. 627, 78th Cong., 1st Sess. 24 (1943), which accompanied the enactment of Section 116(j) of the 1939 Internal Revenue Code, the predecessor of 26 U.S.C. § 912(2):

> [T]he income tax thus nullifies in large measure the efficacy of the allowances to meet official expenses incurred by personnel on foreign assignment, and granted in order to meet official requirements.
>
> * * * *
>
> Payment of allowances to meet extra costs of living at individual posts is indistinguishable from the payment of allowances to defray the expenses of operation of the establishment[.]
>
> * * * *
>
> [A]s the allowances are to meet official needs as distinguished from personal requirements, the exclusion of such allowances from tax consideration for this class of personnel is in the public interest.

This same language from the legislative history has been quoted extensively by the federal courts, and uni-

versally accepted as authority for Congress' purpose in establishing a tax-free COLA for federal employees outside the continental United States. *See Sjoroos v. Commissioner*, 81 T.C. 971, 973 n.6 (1983); *Grauvogel v. Commissioner*, 768 F.2d 1087, 1089 n.3 (9th Cir. 1985); Rev. Rul. 59-407, 1959-2 C.B. 19, 20, § 4.02. As restated by the Ninth Circuit Court of Appeals:

> The legislative history of section 912(2) indicates a legislative purpose to offset rising taxes and living costs of civilian employees overseas without increasing their COLA [citations and footnote omitted]. This decision implements broader congressional policy on administration of federal government activity outside the continental United States.

Grauvogel v. Commissioner, 768 F.2d 1087, 1089 (sustaining the COLA tax exemption against an equal protection challenge by an Alaska state employee).

The same legislative purpose was observed in another equal protection challenge to the COLA tax exemption. In *Sjoroos v. Commissioner of Internal Revenue*, 81 T.C. 971 (1983), the Tax Court referred extensively to the legislative history of the exemption granted by Section 912(2) of the Internal Revenue Code:

> The legislative classification made by the section thus reflects a policy decision by Congress as to how Federal employees should be recompensed for the added living costs they incurred while assigned to certain locations, i.e. by exemption of the cost-of-living allowances rather than by an increase in the amounts thereof.

Sjoroos, 81 T.C. at 974-75. Thus, by exempting the COLA from federal income tax, Congress clearly intended to avoid nullifying the efficacy of the COLA by taxation, while also avoiding increasing the COLA to offset any taxes imposed on it.

It cannot reasonably be argued that Puerto Rico's taxation of the COLA, at rates which cause a greater reduc-

tion than the federal income tax, does not present a grave obstacle to the accomplishment and execution of Congress' full purposes and objectives in granting the COLA. It should be noted that the Puerto Rico legislature has not specifically imposed its income tax on the COLA; rather, Puerto Rico's taxation of the COLA results solely from the Secretary's interpretation that COLA is included within the general definition of gross income.

The Puerto Rico courts gave short shrift to this implied pre-emption analysis, relying primarily on the absence of explicit pre-emption language in Congressional legislation (App. 7a, 26a, and 39a). Their pre-emption analyses conclude in essence that if Congress intended to pre-empt local taxation of the COLA, it would have said so. However, in the pre-emption context, "[t]his Court generally is reluctant to draw inferences from Congress' failure to act." *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 306 (1988). The Puerto Rico courts have ignored the crux of the implied pre-emption analyses, that Puerto Rico's taxation of the COLA frustrates Congress' purposes in providing a COLA free from diminution by federal or equivalent Puerto Rico income taxes.

II. THE UNITED STATES HAS NOT AUTHORIZED PUERTO RICO'S TAXATION OF THE NONCOMPENSATORY COST-OF-LIVING ALLOWANCE.

The Public Salary Tax Act of 1939 provides the United States' consent to non-discriminatory taxation by duly constituted taxing authorities of "pay or compensation for personal service as an officer or employee of the United States[.]" 4 U.S.C. § 111 (App. 50a). In all essential respects, this statute embodies the judicially developed doctrine of intergovernmental tax immunity. *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 812-14 (1989).

Substantial portions of the Puerto Rico courts' opinions in this case are devoted to explaining why no genuine

issues of fact precluded summary judgment on this question, especially with respect to possible *preferential treatment* for certain allowances received by members of the Puerto Rico national guard. However, the plaintiffs in this case have been prevented from discovering evidence of the Puerto Rico treasury department's administrative practices which would constitute discriminatory taxation of the COLA. In view of the constraints placed upon them at the trial court level, the federal employees are unable at this stage of the proceedings to base their challenge to Puerto Rico's taxation of the COLA on impermissible discrimination under 4 U.S.C. § 111.

The petitioners here contend that the COLA, by its nature and according to federal law, is non-compensatory in character. Accordingly, Congress has not expressly authorized Puerto Rico's taxation of the COLA under 4 U.S.C. § 111. Certainly, the Public Salary Tax Act does not waive Congress' power to pre-empt Puerto Rico's taxation of the COLA.

Determination of the character of the COLA is a question of federal law under the applicable federal statutes. *See, e.g., U.S. v. Onslow County Board of Education*, 728 F.2d 628, 636 (4th Cir. 1984), *citing California v. Buzard*, 382 U.S. 386, 393 (1966) (State labels for forms of taxes are not conclusive).

The federal Internal Revenue Service has specifically analyzed this question in order to clarify the status of the COLA and other types of allowances granted to federal employees in both foreign and non-foreign assignments. Based on the legislative history of the federal tax exemption for the COLA, the Internal Revenue Service has characterized the COLA as follows:

> A cost-of-living allowance, within the meaning of section 912(1), is an allowance based on living costs substantially higher than the cost-of-living in the District of Columbia and granted to enable employees to render more complete and efficient service in carry-

> ing out their official assignments. Such allowances are *noncompensatory in character.*

Rev. Rul. 59-407, 1959-2 C.B. 19, 20, § 4.02 (emphasis added), *citing* S. Rep. No. 627, 78th Cong., 1944 C.B. 973, 992. In its ruling, the IRS carefully distinguished the COLA from other types of allowances and differentials granted as recruitment incentives by reason of environment or location of the duty, and allowances "considered as part of the compensation in fixing salary." *Id.*, § 405. Thus, for decades the federal agency charged with interpreting and administering Congress' purposes in this area of the law has held that the COLA cannot properly be described as "compensation."

Unlike basic pay and other forms of "compensation," the COLA is subject to increase or decrease by reason of measured differences in the costs of living between the COLA areas and Washington, D.C. Moreover, it is also not included in basic pay for purposes of computing federal employees' retirement benefits. 5 U.S.C. § 8331(3).

In *Anderson v. United States*, 16 Cl. Ct. 530 (1989), *aff'd* 929 F.2d 648 (Fed. Cir. 1991), the federal courts recently construed the character of certain payments for living quarters and temporary lodging received by federal civilian employees on overseas assignments for the purpose of determining whether that allowance constituted "wages" subject to FICA withholding. These allowances, granted pursuant to the Overseas Differentials and Allowances Act ("ODAA"), 5 U.S.C. § 5923, are exempted from federal income taxation under 26 U.S.C. § 912, the same code section that exempts the COLA. However, Congress has not expressly applied that exclusion to FICA withholding.

The Claims Court held that such allowances were in the nature of reimbursements for federal employees' additional expenses, and that Congress did not intend them to be considered as "compensation" for tax purposes.

Anderson v. U.S., 16 Cl. Ct. 530, 537 (1989). In affirming, the Federal Circuit concluded:

> In contrast, ODAA payments have never been within the definition of "gross income." ODAA payments have always been specifically excluded from being treated as income under section 61(a). . . . [I]t follows that ODAA payments cannot be treated as "wages" under FICA if they are not first made "income."

Anderson, 929 F.2d at 654. Similarly, because COLA payments are excluded from gross income for taxation purposes as a matter of federal law, they cannot be considered "pay or compensation" under 4 U.S.C. § 111.

In view of *Anderson*, the holding of the court in *Romero v. Brady*, 764 F. Supp. 227 (D. Puerto Rico 1991), that the COLA is subject to income tax withholding under federal law, is clearly erroneous. The *Romero* case, upon which the Puerto Rico courts relied (see App. 7a, 21a), is currently on appeal to the Federal Circuit *sub nom Romero v. United States*, No. 91-1440.

Considering Congress' purposes in granting the COLA, and its intent that the COLA be noncompensatory in character, the Public Salary Tax Act does not provide Congress' consent or authorization for Puerto Rico to tax the COLA.

CONCLUSION

Puerto Rico's taxation of the COLA clearly contravenes Congress' intent with respect to the noncompensatory character of the COLA, and impermissibly interferes with accomplishment of Congress' purpose in granting the COLA. This interference with the right to receive a COLA free from diminution by taxation affects federal law enforcement personnel, engineers, air traffic controllers, mail carriers, social security administration clerks, and thousands of other civilian federal employees who provide essential federal services to the Commonwealth of Puerto Rico. By taxing the COLA, the Secretary has

disregarded all notions of comity with respect to Puerto Rico's federal relations. The Secretary should not be allowed to balance Puerto Rico's budget on the backs of federal employees.

The courts of Puerto Rico have misunderstood their role in passing on the important questions of federal law in this case. The Supreme Court of Puerto Rico has held that it cannot invalidate Puerto Rico's tax "by judicial fiat" (App. 9a). The Puerto Rico courts have jealously guarded Puerto Rico's power to tax, a power which they have announced that they are unwilling to surrender easily (App. 9a, 27a, 32a). However, as this Court has held, " '[t]he relative importance to the State of its own law is not material when there is a conflict with a valid federal law, for the Framers of the Constitution provided that federal law must prevail.' " *Fidelity Federal*, 458 U.S. at 153, *quoting Free v. Bland*, 369 U.S. 663, 666 (1962).

For all these reasons, this Court should grant the federal employees' petition, and on review, invalidate the Secretary's taxation of the COLA.

Respectfully submitted,

ROBERT G. MULLENDORE
Counsel of Record
WILLIAM C. WATT
MULLENDORE, TAWNEY & WATT, P.C.
310 West Spruce
Missoula, Montana 59802
(406) 542-5000
Counsel for Petitioners

May 27, 1994

APPENDIX A

IN THE PUERTO RICO SUPREME COURT

No. CE-93-14

Certiorari received as review

MYRNA RODRÍGUEZ, JUAN E. LUGO and others,
Plaintiffs-Petitioners

v.

SECRETARY OF THE TREASURY and others,
Defendants-Appellees

Opinion of the Court issued by
Associate Justice Negrón García

San Juan, Puerto Rico on 1 March 1994

May the Commonwealth of Puerto Rico legitimately impose an income tax on the pay received by federal civil service employees as a *cost of living allowance (COLA)*?

I

Myrna Rodríguez receives the aforesaid *additional* pay and the Treasury Department taxes her for it. To facilitate the collection thereof, Treasury maintains a withholding agreement with the United States Treasury.[1]

In 1987, she, together with other employees, went to Federal Court to petition for reimbursement of such taxes. That action was dismissed for lack of jurisdiction —*Parker v. Agosto Alicea,* Civil No. 87-0386 (DC, Puerto Rico)—, which judgment was confirmed by the

[1] *Romero et al v. Brady, et al.,* 764 F. Supp. 227 (D. Puerto Rico 1991).

First Circuit Court of Appeals in *Parker v. Agosto Alicea*, 878 F 2d 557 (1989).

Hence, on 9 June 1989, Rodríguez and some co-workers in the same situation, questioned the legality of those taxes in the Superior Court, San Juan Part, and petitioned for reimbursement thereof. The Government was opposed. After several proceedings in court, both parties petitioned for summary judgment.[2]

On December 17, 1992, said forum (Hon. Gilberto Gierbolini), entered summary judgment in favor of the Commonwealth. It based its analysis on our Income Tax Law and on the conclusion that the United States Congress had *not* immunized the COLA from state or territorial taxes. With respect to the claim of a different or unequal tax treatment, it concluded that the *subsistence allowance* or *quarter* [*sic: should read "quartering"*] *allowance* which *members of the National Guard* receive is different, and moreover, the military's COLA is *equally taxable*.

At the request of plaintiffs Rodríguez *et al.*, we reviewed.[3]

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[2] With regard to that proceeding, the court delimited the controversies as follows:

> "(a) whether the COLA is taxable in Puerto Rico.
>
> (b) whether the Government of the United States of America consented to the Government of Puerto Rico's levying taxes on the COLA [and]
>
> (c) if the above are ruled on in the affirmative it should also be decided whether there exists an alleged act of discrimination in favor of another group which bars the levying of taxes from plaintiffs (federal Civil Service employees)."

[3] While termed *certiorari*, we have taken it on as a review. In support thereof they discuss the following propositions:

> A. [. . .] To rule through summary judgment that there is no genuine controversy of facts with regard to the aspect of discrimination.
>
> B. [. . .] To find that the taxation of the COLA does not generate discrimination and by not determining that it violates

II

Let us concentrate first on the assertion of a *procedural* nature. A summary judgment is in order if "the briefs . . . [depositions], answers to interrogatories, and admissions offered, together with the sworn statements, if any, demonstrate *that there is no genuine substantial controversy regarding any material fact and that as an issue of law, summary judgment should be entered in favor of the movant.*" Rule 36.3, Civil Procedure. (Emphasis supplied). We reiterate its usefulness and purpose of guaranteeing a fair, speedy and economical solution. *Toledo Maldonado v. Cartagena Ortiz,* rul. on December 21, 1992; *Rivera Santana v. Superior Packing, Inc.,* dec. on December 9, 1992; *Méndez Arocho v. El Vocero,* dec. on June 30, 1992; *Corp. of the Presiding Bishop v. Purcell,* 117 D.P.R. 714 (1986).

The judgment at bar responds to that vision. The documents before us reflect that appellants Rodríguez *et al., did not* demonstrate the existence of *material facts* in controversy. The hearing held on October 23, 1992 to clarify the alleged controversies which barred their summary adjudication revealed—through a deposition of Wil-

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the uniformity clause of the Commonwealth's Constitution [*sic*].

C. [. . .] To not guarantee petitioners a de novo trial or civil suit with all the procedural guarantees provided by the procedure for petitioning for reimbursement under the Puerto Rico Income Tax Act, 13 L.P.R.A. Sec. 3323(A).

D. [. . .] To enter summary judgment without finishing with the procedure for written discovery and to oblige petitioners to file an answer to the amended summary judgment in ten days without permitting them to have the benefit of the discovery relating to the interrogatories, the production of documents and the requests for admissions.

E. [. . .] To find that the COLA is compensation or payment or income for federal employees.

F. [. . .] To conclude that the supremacy clause does not bar the taxing the COLA of federal employees in Puerto Rico.

liam Stuart Collazo, an ex-functionary of the Department of the Treasury—, that the military's COLA *is also taxed*, and that it is an *additional, separate item* from those of the quartering and subsistence allowances. It was also shown that the aforesaid subsistence and quartering allowances of the military are different stipends from the COLA which other federal employees and the military themselves receive. As their names illustrate, the quartering allowance is specifically for housing and the subsistence allowance is for the soldiers' sustenance. 37 U.S.C.A. Secs. 402 and 403.[4]

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[4] Executive Order No. 11157 of June 22, 1964, 29 F.R. 7973, as amended by other orders through No. 12762 of June 4, 1991, 56 F.R. 25993, 37 USCA 301 (1993 Supl.) is illustrative of these stipends.

With regard to the basic allowances for subsistence it states:

> "Sec. 301. Members of the Armed Forces who are granted in kind subsistence for use of the cafeteria, whose duties require their absence from the base for one or more meal periods, shall be entitled to receive a quota of the daily subsistence allowance for said meals, authorized for active members on bases where in kind rations are not available.[. . .]"

And in 37 USCA 402 the following is explained:

> "[. . .]
>
> (b) An enlistee is entitled to the basic subsistence allowance in the following situations—
>
> (1) when in kind rations are not available;
>
> (2) when the use of a cafeteria permit is granted separately; and
>
> (3) when he is assigned to service in emergency situations in which cafeteria resources of the United States are not available.
>
> [. . .]

As for the basic allowances for quarters it states:

> "[. . .]
>
> (b) Except where provided otherwise by law, a member of the Armed Forces who has assigned quarters in the United States or quartering facilities under the jurisdiction of one of the branches of the Armed Forces, consonant with his grade, rank and wage scale, and which are adequate for him and his

For their part, appellants Rodríguez *et al.*, receive a cost of living allowance under 5 USCA 5941, which reads:

> "(a) Available allotments or funds for an agency of the Executive, except a corporation under governmental control for wages of employees in service outside the continental jurisdiction of the United States, or in Alaska, whose basic wage scales are provided by law, are available to pay the allowances of these employees. The allowance is based on—
>
> (1) costs of living substantially higher than in the District of Columbia;
>
> (2) living conditions where the environmental factors are substantially different from environmental living conditions in the continental United States and warrant an allowance as a recruiting incentive; or
>
> (3) both factors.
>
> The allowance may not exceed 25 percent of the basic wage scale. [. . .]"

It is clear that the COLA constitutes a payment or *compensation additional to the basic wage* received by federal civil service employees. Appellants Rodríguez *et al.*, do not receive quartering or subsistence allowances. There is no preferential treatment whatever; it is a question of different items and payment headings which do not amount to discriminatory treatment of any sort.

Thus, the Court did *not* err in using the summary action. Although appellants Rodríguez *et al.* alleged it, they failed to prove the existence of discriminatory practice

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dependents, if any, shall not be entitled to the basic allowance for quarters. Nevertheless, subject to the provisions of subsection (j), a member without dependents [. . .] may choose not to use said quarters and instead receive the basic quartering allowance prescribed in this section for his wage scale.[. . .]". 37 USCA 403.

or preferential treatment in persons *similarly situated.* It is well known that a different tax treatment, of stipends of a different nature, does not constitute a preferential or discriminary treatment *per se.*

III

In its *substantive* aspect, the lower Court did not err in concluding that the COLA is a payment or income, and there is no prohibition barring its taxation in Puerto Rico.

As stated, the granting of the COLA to federal civil service employees is based in the fact that here the cost of living is substantially higher than that in the District of Columbia and/or as a recruitment incentive because of the substantial differences in the conditions of the environment compared to the North American mainland. 5 U.S.C.A. Sec. 4941(a)(1) and (2). According to the U.S. Income Tax Code's definition of *gross income,* the COLA *is not* taxable. 26 USC 912.[5] For federal income tax purposes, of the two types of stipends or differentials paid by the federal government to its civil servants located

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[5] It reads:

"The following items shall not be included within gross income and shall be exempt from the payment of taxes under this subtitle:

[. . .]

(2) Cost of living allowance—In the case of functionaries or civil employees of the Government in service outside the continental jurisdiction of the United States (except Alaska), the sums (except the sums received under Title II of the Differentials and Allowances Act) received as cost of living allowances, in accordance with the regulations enacted by the President (or in the case of functionaries and employees of the United States Judiciary, in accordance with the analogous regulations).

[. . .]". 26 U.S.C. 972.

Refer also to 26 U.S.C.A. Sec. 265 where provisions are made in regard to not permitting non-taxable income deductions.

off the mainalnd, only one is taxable. The COLA received by appellants Rodríguez *et al.*, is *not* income, since it is excluded from Section 921(1) of the Federal Internal Revenue Code of 1954"). Revenue Rulings 59-407, p. 745. And curiously, the state tax levied on the COLA is used as a classic example of a disallowed deduction for federal tax purposes. *Mertens Law of Federal Income Tax*, Sec. 27.10, p. 28.[6]

The statute which grants the COLA to federal employees is silent on state or territorial taxation.[7] In contrast, the *Public Salary Tax Act of 1939*, 4 U.S.C. Sec. 111)—authorized the states to tax the [*sic*] earned by federal employees as follows:

> "The United States *allows* the levying of income taxes or taxes on compensation for personal services rendered by a functionary or employee of the United States, its territories or possessions, or political subdivisions, the government of the District of Columbia, or an agency or dependency of the above, by a duly constituted tax authority with jurisdiction, if said taxes do not discriminate against a functionary or employee in terms of the source of income or compensation."

In *Davis v. Michigan Dept. of Treasury*, 489 U.S. 8093 (1989) the Supreme Court analyzed the cited act and ruled that the govering criterion was that there be no discrimination based on the source of income. It annulled a Michigan statute which levied a tax on retired federal

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[6] *Mertens* cites *Lappin v. U.S.*, 655 F. Supp. 1344 (D. Hav., 1987), where the deductions requested by a federal employee residing in Hawaii for the state tax which he paid on his COLA were denied. Revenue Ruling 74-140, 1974-1 CB50, as cited in *Mertens, supra*, Sec. 27.94, p. 231.

[7] Nevertheless, it has been ruled that the federal COLA tax exemption or its exclusion as gross income under federal law, does not affect the definition of income used in the withholding agreement of the Secretary of the Treasury with the Federal Treasury Department. *Romero v. Brady, supra*, note 1.

government employees and excluded state retirees. The highest forum ruled:

> "Under our case law, the levying of a major tax burden on persons who pay taxes under one tax regimen as opposed to others under a different tax regimen, must be justified by differences between the two tax classes." *Phillips Chemical Co. v. Dumas Independent School Dict.*, 361 U.S. at 383. We must not depend only on the analysis of the cases decided by this Court under the equal protection of the law clause to determine if the classifications satisfy the criteria of justification. We have ruled that our decisions under the cloak of the equal protection under the law clause, do not set precedents in cases in which matters are involved concerning intergovernmental tax immunity, since the interest of the government must be *pondered*. *Id.*, p. 305, 4 L. Ed. 2d. 384, 80 S. Ct. Section 474. On the contrary, the matter depends on determining whether the inconsistency in the tax treatment is owing to, and is justified by, significant class distinctions'. *Id.* pp. 383-385, 4 L. Ed. 2d 384, 80 S. Ct. 474.'

Subsequently, *Barker v. Kansas*, 60 L.W. 4322 (1992), 118 L. Ed. 243, 249 (1992), reiterated that the doctrine of intergovernmental tax immunity is extended today to the prohibition against the *discriminatory* taxation contained in the aforesaid Sec. 111.

Our Income Tax Law, 13 L.P.R.A. sec. 3001 *et seq.*, as amended, visualizes gross income as encompassing any kind of remuneration. It includes:

> "[. . .] gains, profits and income derived from salaries, wages, or compensation for personal service (including payment for services as an officer or employee of the Commonwealth of Puerto Rico, of any State of the Union, of the United States, or any political subdivision, or any agency or instrumentality of any of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations,

> trades, buinesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the possession or use of or interest in such property; also from interest, rent, dividends, partnership profits, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever [. . .]". 13 L.P.R.A. Sec. 3022. [*Official translation, Laws of Puuerto Rico Annotated*].

On the other hand, in the pertinent provisions, the COLA of federal employees is not included among the exemptions or exclusions from gross income provided in our Tax Law. *We cannot do it by judicial fiat. Berwind Lines, Inc. v. Siro. de Hacienda,* 113 D.P.R. 658, 660 (1982); *Esso Standard Oil v. A.P.P.R.*, 95 D.P.R. 772, 784 (1968).

Our Constitution recognizes the power of the Commonwealth to levy and collect taxes and authorizes their levying and collection by the municipalities, as provided by the Legislative Assembly. *Art. VI, Sec. 2.*

Based thereon, almost three decades ago, in *R.C.A. v. Gobierno de la Capital,* 91 D.P.R. 416, 440 (1964), we attested to our reluctance to surrender that power easily; we only annulled it when it was exercised contrary to the applicable provisions of the Constitution or "in violation of the legal and moral obligations which the people accepted in their Federal Relations." Those circumstances are not present here.

The interpretation which the Puerto Rico Department of the Treasury made in 1973, that the COLA constitutes income, subject to the payment of taxes, is valid and constitutional.

On the grounds enunciated, judgment of affirmance is entered.

ANTONIO S. NEGRON GARCIA

/s/ Antonio S. Negron Garcia
Associate Justice

IN THE SUPREME COURT OF PUERTO RICO

No. CE-93-14

Certiorari invoked as an appeal

MYRNA RODRIGUEZ, JUAN E. LUGO, *et al.*,
Plaintiffs-Petitioners,

v.

SECRETARY OF THE TREASURY, *et al.*,
Defendants-Respondents.

Concurrent and acquiescent opinion issued by ASSOCIATE JUSTICE HERNANDEZ DENTON, joined by Associate Justice Naveira de Rodón San Juan, Puerto Rico, March 1, 1994

Appeal by federal employees against Superior Court judgment which dismissed their demand for reimbursement against the Secretary of the Treasury. We agree with the Court's opinion, concluding that the trial court did not err in using summary procedure to dismiss the suit filed by Petitioner, and that COLA is an item validly taxable to Puerto Rico. In view of the importance of the disputes before us, we deem it necessary to state our opinions separately.

I

Plaintiffs-Petitioners are federal employees in the civil service, who earn additional pay as part of their salary, in the form of an adjustment percentage as a cost of living allowance (henceforth COLA). This item is considered taxable income in Puerto Rico, and the Department of the Treasury collects the pertinent tax pursuant

to a deduction agreement with the federal Department of the Treasury.

Being unsatisfied with this tax, the federal employees sued for reimbursement in federal court, which dismissed the case for lack of jurisdiction. Thereupon the taxpayers brought suit at Superior Court, San Juan Part. Defendant moved for summary dismissal of the suit, opposed by the federal employees, who also moved for summary judgment in their favor.

A hearing was held to discuss both parties' pleadings, and the trial court summarily dismissed the complaint, on the grounds that Congress did not exempt COLA beneficaries from payment of state taxes on their COLA earnings. Unsatisfied with this decision, the federal employees appealed to us, claiming, in sum, that the trial court erred on concluding that COLA is salary or compensation, and by rejecting the argument that the federal supremacy clause bars taxation of COLA in Puerto Rico. They are wrong. Let us see.

II

The federal employees petitioners state that it was out of order for the court to enter a summary judgment. *Firstly* they adduce that there was real conflict regarding an essential fact: that the members of the National Guard pay taxes in Puerto Rico on the bed and board they receive. They explain that this is an essential fact, since if it proved that National Guard members (deemed to be commonwealth employees) pay no tax on these items, this would constitute discrimination against the federal employees on the basis of the source of their income. They claim such discrimination is forbidden by the Public Salary Tax Act of 1939, 4 U.S.C. Sec. 111.[1]

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[1] This statute provides as follows:

"The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United

Secondly: The federal employees claim that the trial court summarily dismissed the complaint without any discovery, which would be required to adequately oppose the motion for summary judgment submitted by the defendants. The records of the case show that discovery was intended to support the allegation that members of the National Guard pay no tax on their allowances for bed and board.

Thirdly: Appellants allege that use of the summary procedure deprived them of their right to a *de novo* trial guaranteed by the Puerto Rico Income Law Tax and by the Uniform Administrative Procedure Act.[2] Let us see.

The allegedly discriminatory treatment did not take place. We concur with the Court's opinion that the allowances for bed and board received by the National Guard are entirely different from the COLA earned by the federal employees. Therefore the controversy over whether the former are taxable in Puerto Rico or not was not essential to the decision in the case and did not hinder

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States, a territory or possession or political subdivision thereof, the government of the District of Columbia or an agency are instrumentality of one or more of the foregoing, by a duly constituted taxing authority having jurisdiction, *if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.*" 4 U.S.C. Sec. 111. (Emphasis added).

[2] The Uniform Administrative Procedure Act provides that:

"The provisions of this subchapter (on judicial review) shall apply to those orders, resolutions, and provisions dictated by agencies or administrative officials which shall or may be reviewed by the Superior Court of Puerto Rico, except those issued by the Secretary of the Treasury relative to the internal revenue laws of the Commonwealth, which shall be reviewed upon petition and de novo trial. Any complainant who contests the determination of deficiency by the Secretary of the Treasury shall pay any uncontested partion (sic) of tax that is due and owing and shall raise bail for the unpaid amount as determined by the Secretary of the Treasury, on or before presentation of the complaint." 3 LPRA Sec. 2171. See also the Income Tax Act of 1954, 13 LPRA Sec. 3323(a).

selection of the summary procedure for judgment. By the same token the trial court need not have granted an extension of time for conclusion of the discovery demanded by the federal employees.

Nor were petitioners deprived of their right to a *de novo* trial. This right implies that the trial court need not restrict itself to the decision whether the Department of the Treasury's conclusions were supported by substantial evidence or not; but rather it was empowered to rule on matters both of fact and of law. *Granados Navedo v. Rodríguez Estrada,* 89 JTS 63; *Vélez Quiñones v. Secretario de Instrucción,* 86 D.P.R. 755 (1962). As in a regular trial, the court has before it all the evidence, in addition to pleadings and memoranda of law, and decides the case through independent evaluation. A *de novo* trial, like any other, is governed by the Rules of Civil Procedure, among which are the rules regarding motions for summary judgment. Nothing prevents summary decision of a case like this one, provided the latter complies with those rules.

On the grounds enumerated above, the first four errors claimed by petitioners were not committed. Hence we should evaluate the last two errors, which raise the following issues: is COLA pay or compensation, so that states are empowered by the Public Salary Tax Act to levy taxes on this allowance? Does the Department of the Treasury's imposition of tax on COLA violate the federal Supremacy Clause, despite Congress's exemption of this sum from federal taxation? Let us see.

III

Petitioners claim that Congress did not authorize commonwealth taxation of COLA. In sum, they assert that COLA is neither pay nor compensation, pursuant to the meaning of the Public Salary Tax Act, 4 USC Sec 111, whereby Congress barred the states from levying taxes on

the federal employees' salaries.[3] They further state that the federal government defined COLA as a non-compensatory item and that such definition must prevail, since it comes from the entity which authorized the levying of taxes on its employees' salaries.

For his part, the Attorney General alleges that in the federal jurisdiction COLA is considered additional compensation, hence taxable under 4 USC 111. He adds that COLA is exempt only from federal taxation, but not from state taxation. He concludes that in Puerto Rico COLA is taxable income under section 22(a) of our Income Tax Act, 13 L.P.R.A. sec. 3022(a).

Solving this controversy requires analysis of the origins of COLA. This allowance arose by virtue of the Independent Offices Appropriations Act of April 20, 1948, which provided that by order of the President, a salary or compensation would be paid to employees working outside of the continental USA or Alaska, up to a maximum of 25 per cent of basic pay.

> "Except as otherwise provided by law, any appropriations or funds available to the executive departments, independent establishments, and corporations for the payment of *salaries* and *compensation* to persons employed outside the continental United States or in Alaska shall be available for the payment of such *salaries* and *compensation* only in accordance with regulations prescribed by the President at rates of pay equal to those paid for the same or similar services of persons employed by the Government in continental United States, plus not to exceed 25 per centum: Provided, that no such *salary* or *compensation* shall exceed the maximum provided by the Clas-

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[3] Before approval of the Public Tax Act, for more than a century the doctrine of intergovernmental tax immunity prevailed, which protected the federal government from state taxes and vice versa. This protection extended to the salaries of federal employees.

sification Act of 1923, as amended." Apr. 20, 1948, ch. 219, Sec. 207, 62 Stat. 194.

The above provision was soon amended by the Supplemental Independent Officers Appropriations Act of June 30, 1948, which explained that this additional compensation was to be paid for differences in the cost of living or for conditions of the environment which might require an incentive to the hiring of personnel.

> "Sec. 104. Section 207 of the Independent Offices Appropriation Act, 1949, is hereby amended to read as follows:
>
> "Sec. 207. Any appropriations or funds available to the executive departments, independent establishments, and wholly owned Government corporations for the payment of salaries and compensation to persons stationed outside the continental United States or in Alaska whose rates of basic compensation are fixed by statute, shall be available for the payment of *additional compensation* to such persons, based on living costs substantially higher than in the District of Columbia, or conditions of environment which differ substantially from conditions of environment in the States and warrant additional compensation as a recruitment incentive, or both such factors: Provided, That such *additional compensation*, except as otherwise specifically authorized by law, shall be paid only in accordance with regulations prescribed by the President establishing rates of *such additional compensation* and defining the area, groups of positions, and classes of persons to which each such rate applies: Provided further, That no *additional compensation* based on living costs substantialy higher than in the District of Columbia shall be paid under this section to any person who is entitled to receive a cost-of-living allowance under section 901(2) of the Foreign Service Act of 1946 or section 204 of this Act: Provided further, That such *additional*

compensation shall not exceed in any instance 25 per centum of the rate of basic compensation: Provided further, That this section shall be effective sixty days after the date of approval of this Act, or on such earlier date as may be specified in regulations issued by the President hereunder, and additional compensation payable under regulations and procedures in effect on the date of approval of this Act may continue to be paid until de effective date of this section." (Emphasis added) June 30, 1948, Ch. 775, Sec. 104, 62 Stat. 1205.

Simple perusal of the language of both provisions clearly reveals that Congress' original intention was to consider COLA a form of additional compensation for services rendered. Therefore this item was subject to federal taxation.

In 1966 the above-mentioned statute was again amended by substitution of the term "allowance" for the phrase "additional compensation", since the former was considered more consistent and precise.[4] However, this amend-

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[4] The provision in its present form ordains:

La disposición en su versión actual establece:

"(a) Appropriations or funds available to an Executive agency, except a Government controlled corporation, for pay of employees stationed outside the continental United States or in Alaska whose rates of basic pay are fixed by statute, are available for *allowances* to these employees. The *allowance* is based on—

(1) living costs substantially higher than in the District of Columbia;

(2) conditions of environment which differ substantially from conditions of environment in the continental United States and warrant an allowance as a recruitment incentive;

or

(3) both of these factors.

The *allowance* may not exceed 25 percent of the rate of basic pay. Except as otherwise specifically authorized by statute,

ment did not change the compensatory nature of COLA, as may be seen by the interpretations thereof made afterwards by the executive branch of government and by federal case law. Let us see.

Fulfilling a duty imposed by the Independent Offices Appropriations Act, as amended, the President of the United States regulated for the first time payment of COLA in Executive Order number 10,000 of September 16, 1948, 13 FR 5453. This order refers to COLA as additional compensation, as may be seen in the following text:

> "Part I—ADDITIONAL COMPENSATION IN FOREIGN AREAS
>
> . . .
>
> Section 109. Additional living cost compensation. No executive department, independent establishment, or wholly owned Government corporation shall pay, pursuant to section 207 of the Act, *additional compensation* to any employee located in any foreign area by reason of living costs which are substantially higher than those in the District of Columbia: Provided, That this section shall not be construed to prevent any payment under section 204 of said Independent Offices Appropriation Act, 1949, or under other appropriate authority.
>
> . . .

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the *allowance* is paid only in accordance with regulations prescribed by the President establishing the rates and defining the area, groups of positions, and classes of employees to which each rate applies.

(b) An employee entitled to a cost-of-living allowance under section 5924 of this title may not be paid an allowance under subsection (a) of this section based on living costs substantially higher than in the District of Columbia." 5 U.S.C. Section 5941.

Part II—ADDITIONAL COMPENSATION IN TERRITORIES

. . .

Section 205. Additional living cost compensation. (a) The United States Civil Service Commission shall from time to time, subject to applicable law, (1) designate places in the Territories where it determines that living costs are substantially higher than in the District of Columbia, (2) fix for each place so designated an additional rate or rates of *compensation* to be paid by reason of such higher living costs pursuant to section 207 of the Act, and (c) prescribe such further regulations, governing such compensation, as may be necessary. *Additional compensation* so fixed is hereafter in this Part referred to as "Territorial cost-of-living allowance".[5]

Several executive orders have followed amending it, but they have reiterated the language used.[6] As a matter of fact, the sections cited above as examples of the use of the phrase "additional compensation" when referring to COLA, remain unaltered in that regard. If the congressional and presidential intent had been not to consider COLA non-compensatory income, the executive or-

[5] Executive Order no. 10,000 regulated (1) payment of the additional compensation to federal employees who work outside of the continental United States or in Alaska, discussed in the first three parts of the order, (2) payment of differentials on salaries of officials and employees of the Foreign Service, on the basis of Section 443 of the Independent Offices Appropriations Act and contained in the fourth part of order (3) payment of differentials for working in "unhealthful foreign posts", by section 853 of the same statute, in part five of the order. Payment of additional compensation on the basis of section 207 of the Independent Offices Appropriations Act is discussed separately, depending on whether it is granted abroad or in U.S. territories.

[6] The following executive orders amended no. 10,000: Ex. Ord. No. 10636, Sept. 16, 1955, 20 F.R. 7025; Ex. Ord. No. 11938, Sept. 29, 1976, 41 F.R. 43383; Ex. Ord. No. 12107, Dec. 28, 1978, 44 F.R. 1055; Ex. Ord. No. 12510, Apr. 17, 1985, 50 F.R. 15535.

ders subsequent to the 1966 amendment would have altered their language in accordance therewith.

Furthermore, if COLA had been considered non-compensatory income, no provision was required in the Internal Revenue Code expressly exempting it from federal taxation.[7] Petitioners claim that COLA is non-compensatory and not a component of taxable income, on grounds of Revenue Ruling 59-407 by the federal Internal Revenue Service, which reads: "Such allowances are non-compensatory in character." However, this statement fails to produce the effect desired by the petitioner taxpayers. The revenue ruling cited merely clarified the status of COLA regarding *federal* taxation, and by stating that it was non-compensatory, it referred to Senate Report 627. This report explained Congress' reasons to exempt COLA from federal taxation and established that such exemption responds to the public interest of exempting this additional remuneration from income tax laws, not to the inherent character of this item.

In *Lapin v. United States*, 617 F. Supp. 167 (DCDC 1985) the argument that COLA is not income because it is not compensatory, was rejected. The court stated as follows:

> [cite p. 11]
>
> "Plaintiffs contend, however, that the COLA is not income within the meaning of Section 265(1) be-

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[7] In 1943 a new sub-section was added to section 116 of the federal Internal Revenue Code, in order to exclude the following items from gross income: (1) COLA earned by federal employees abroad; (2) differentials received by ambassadors, ministers and consuls, and (3) COLA received by civilian employees of the federal government working outside of the continental United States, by virtue of the President's regulation. By Revenue Ruling 237, C.B. 1953-2, 52, it was decided that the exemption included in section 116(j) applied to COLA received by virtue of the Independent Offices Appropriations Act of 1939, section 207. Later, in 1954, section 116 was reorganized and renumbered section 116, while section 912 remained as it is now.

> cause it is noncompensatory in character. Plaintiff relies principally on a Senate report concerning the exemption from federal income tax of certain COLAs granted to federal employees. *There is nothing in the report, however, that even suggests that COLAs are not considered income. Under the Internal Revenue Code, gross income means all income from whatever source derived, unless excluded by law.* Treas. Reg. 1.61. The COLA at issue in this case is a class of income excluded by I.R.C. Section 912 from gross income." (Emphasis added, annotation omitted)[8]

In addition to the above, American case law describes COLA as "a federal program *supplementing* basic pay of employees living in designated non-foreign areas . . ." *Alaniz v. Office of Personnel Management*, 545 F. Supp. 1182 (Alaska 1982); *Curlott v. Campbell*, 598 F. 2d 1175 (1979).[9] This ratifies its compensatory nature.

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[8] In *Lapin* the federal employee living in Hawaii paid state taxes on COLA and took the pertinent deduction on his federal return, since it was a state tax which had been paid. However, this deduction was denied him because it was from exempt income under the Internal Revenue Code. It is nonetheless important to underscore that this case did not consider Hawaii's argument of lack of authority to tax COLA. The court states in note 4:

> "In his "supplemental motion for summary judgment," plaintiff also claims that the State of Hawaii unlawfully taxed the COLA which is exempt from federal income tax. He seeks for all federal employees affected a refund of income taxed paid to the State of Hawaii on the COLA. *The State of Hawaii is not a party to this action. Accordingly, plaintiff's claim is not properly before the Court.*"

[9] According to the Federal Personnel Manual, sec. 591-41(d)(1) (1969), COLA is not included, like basic pay, in the calculation of overtime, night work differentials, vacations, retirement deductions or other additional payments. *Burns v. United States Post Office*, 380 F. Supp. 623 (1974). Nonetheless, it is indeed considered part of basic pay in order to determine the new salary of blue-collar workers who become white-collar employees in the federal government. *Sam v. United States*, 682 F.2d 925 (1982).

On the other hand, in *Romero v. Brady*, 764 F. Supp. 227 (D.P.R. 1991), a group of the federal employees working in Puerto Rico challenged the validity of a deduction agreement between the Commonwealth of Puerto Rico and the federal Department of the Treasury, whereby the federal government withholds the federal employee's income tax on the federal employees' salaries, including COLA.[10] Among other arguments, the federal employees claimed that COLA does not constitute salary or compensation, so withholding of taxes on this amount was out of order.[11]

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[10] This agreement was reached by virtue of the following provision:

> "(a) When a State Statute—(1) provides for the collection of a tax either by imposing on employers generally the duty of withholding sums from the pay of employees and making returns of the sums of the State, . . . and (2) imposes the duty or grants the authority to withhold generally with respect to the pay of employees who are residents of the State; the Secretary of the Treasury, under regulations prescribed by the President, shall enter into an agreement with the State within 120 days of a request for agreement from the proper State official. The agreement shall provide that the head of each agency of the United States shall comply with the requirements of the State withholding statute in the case of employees of the agency who are subject to the tax and whose regular place of Federal employment is within the State with which the agreement is made . . ." 5 U.S.C. 5517.

[11] The court summarized the taxpayers' position as follows:

> "Plaintiffs also point to the definition of "compensation" as it appears in the C.F.R. "Compensation as applied to employees of an agency and members of the Armed Forces means wages as defined in 26 U.S.C. 3401(a) and regulations issued thereunder." The definition of wages under section 3401(a) includes "all remuneration (other than fees paid to a public official) for services performed by an employee for his employer . . ." The Internal Revenue Code, however, specifically exempts COLA from "gross income" for purposes of federal tax liability. 26 U.S.C. Sec. 912. It is plaintiffs' position that the exemption in the IRC of COLA from "gross income" also affects the definition of "wages" as defined by section 3401,

The court differed with this interpretation, stating that the decision did not depend on the susceptibility of COLA to federal taxation, but rather on its susceptibility to taxation by the Commonwealth of Puerto Rico. "The definition of 'wages' in section 3401(a), which includes 'all *remuneration*', is broad enough to encompass COLA." (Our emphasis) *Romero v. Brady, supra,* p. 234. If COLA were non-compensatory for other purposes, this item would have been excluded from the withholding agreement between the federal Department of the Treasury and the Commonwealth of Puerto Rico. We see that the United States District Court for the District of Puerto Rico expressly rejected this possibility.

In view of the above, we find that COLA is indeed pay or compensation. Therefore under the Public Salary Tax Act, the states and the Commonwealth of Puerto Rico are empowered to collect taxes on that item. But is COLA a form of taxable income in accordance with our system of taxation?

IV

In Puerto Rico the definition of gross income includes:

> gains, profits, and income derived from salaries, wages, or compensation for personal service (including payment for services as an officer or employee of the Commonwealth of Puerto Rico, of any State of the Union, of the United States, or any political subdivision, or any agency or instrumentality of any of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the possession or use of or interest in such property; also from interest, rent, dividends, partnership profits, securities, or the transaction of any business

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and by reference, 31 C.F.R. section 215(2), and, by incorporation, the agreement." *Romero* v. *Brady*, 764 F. Supp. 227, 234 (D.Puerto Rico 1991).

carried on for gain or profit, or gains or profits and income derived from any source whatever.

It is a recognized principle that tax exemptions, as legislative grace and derogations of sovereign power, should not exceed the express and precise terms of the statute which grants them. Any doubt must be construed adversely to the existence of the exemption, since the rule *expressio unius est inclusio alterius* (explicit mention of a thing implies exclusion of others of the same nature). *Martínez Suria v. Colón Muñoz*, 92 JTS 99. Pursuant to the above, COLA constitutes taxable income because it is not expressly included by the Income Tax Act of 1954.[12]

IV

Finally, petitioners claim that taxation of COLA in Puerto Rico violates the federal Supremacy Clause, since it thwarts Congress' intent of equalizing the economic position of the federal employees in Washington, D.C. and those who work outside the continental United States and Alaska. They state that the purpose of exempting this item from federal taxation was to prevent the diluting consequences of a federal tax burden and the resulting need to increase employees' pay. They argue that state taxation of COLA has the same diluting consequences that federal taxation of income had, and therefore imposition of state taxation would thwart Congress' purpose of providing an incentive to the federal employees working in Puerto Rico.

For his part, the Attorney General denies the above, alleging that there is no express or implied provision

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[12] Alaska does not levy tax on COLA. This is due to the fact that Alaska adopted by reference Section 912 of the Internal Revenue Code, which excludes this item from gross income. *See* Alaska Statutes sec. 43.20.021. On the other hand, Hawaii also adopted by reference the definition of the federal Internal Revenue Code, but expressly repudiated the federal exemption on COLA. *See* Hawaii Revised Statutes, Sec. 7(b), Chapter 235, Title 14.

which bars Puerto Rico from levying taxes on sums earned as COLA.

Pursuant to the federal Supremacy Clause, U.S. Constitution, Art. IV, Sec. 2, federal authority is supreme and any state law or act incompatible with federal authority is unconstitutional. Raúl Serrano Geyles, *Derecho Constitucional de Estados Unidos y Puerto Rico,* vol. I, Colegio de Abogados de Puerto Rico, 1986, p. 410. A federal statute may displace state legislation regarding a certain matter when: (1) Congress expressly states its intention of achieving this goal; (2) although such intent is not express, it may be inferred from Congress' establishment of an extremely detailed system of federal regulation; (3) congressional legislation deals with a matter of special interest to the federation; or (4) the intention of displacing state legislation is revealed by the purpose and obligations imposed by the federal statute. *Pacific Gas & Electric Co. v. State Energy Resources Conservation Commission,* 461 U.S. 190 (1983).

Although the above situations are not present, state legislation may be displaced by a federal statute, provided (1) compliance with both is physically impossible, or (2) the state statute "stands as an obstacle to the accomplishment and execution of the full purposed and objectives of Congress." *Pacific Gas & Electric Co. v. State Energy Resources Conservation Commission, supra.*

In the specific case of state taxes, it should be presumed that Congress had no intention of displacing state legislation. Such displacement is not favored unless powerful reasons indicate, firstly, that the nature of the federal government's interest is such that no other conclusion is allowed, or, second, that Congress had ordered it without a shadow of doubt. The fact that Congress has expressed in general form a federal public policy. *Reynolds Tobacco Co. v. Durham County,* 479 U.S. 130 (1986); *Commonwealth Edison Co. v. Montana,* 453 U.S. 609 (1981).

The question we must ask is therefore: whether Congress intended to displace state legislation. This question is particularly pertinent in cases like this one, in which federal statute fails to state it clearly, and there is no material conflict between the two laws. *Wardain Canada, Inc. v. Florida Department of Revenue*, 477 U.S. 1 (1986).[13]

In the instant case it is alleged that taxation of COLA hinders achievement of Congress' goal of exempting COLA from federal taxes. 26 USCA Sec. 912(2).[14] By granting such exemption Congress explained that levying federal taxes would cancel the efficacy of that item. Since the federal government did not have the requisite funds to compensate employees for the effects of the federal tax

[13] In the present case, Congress has not expressly forbidden states to levy taxes on COLA earned by federal employees. On the contrary, in 1939 it passed the Public Salary Tax Act, 4 USCA Sec. 111, *supra*, giving its express consent to states that levy taxes on COLA earned by federal employees. On the contrary, in 1939 it enacted Public Salary Tax Act, *supra*, expressly consenting to imposition of federal taxation on federal employees' salary or compensation, a term which, as we have seen, includes COLA. By the same token it is not physically impossible to exempt from federal taxation an item of income which at the state level is taxable. Hence the only issue to be decided is whether the susceptibility to taxation, or otherwise, of COLA constitutes a hindrance for the achievement of Congress' purposes and goals.

[14] This provision orders in pertinent part, the following:

"The following items shall not be included in gross income, and shall be exempt from taxation under this subtitle:

. . .

(2) Cost-of-living allowances—In the case of civilian officers or employees of the Government of the United States stationed outside the continental United States (other than Alaska), amounts (other than amounts received under title II of the Overseas Differentials and Allowances Act) received as Cost-of-living allowances in accordance with regulations approved by the President (or in the case of judicial officers or employees of the United States, in accordance with rules similar to such regulations." 26 U.S.C.A. Sec. 912(2).

burden, it was concluded that "the exclusion of such allowances from tax considerations for this class of personnel is in the public interest." Senate Finance Committee (78th Congress, 1st session, S. Report 627), *Seidman's Legislative History of Federal Income and Excess Profits Tax Laws* 1953-1939, vol. 1 to Code Sec. 166 (Prentice Hall, 1954), pp. 1761-1762.

From the above it may be concluded that the exemption granted operates only at the federal level. Had state taxation been an impediment to the achievement of Congress' goals, the latter would have stated its opposition thereto much more clearly. When the exemption was granted, authorization had already been granted to the states by the Public Salary Tax Act, to levying state taxation on federal employees. Therefore it is reasonable to construe Congress' exemption from the levying of federal taxation, as evidence that it was also aware of the effect of state taxation, but did not deem it necessary to provide state exemption.[15] We are faced merely by a general statement of federal policy, which in no wise forbids or limits the states' powers of taxation. Therefore the Supremacy Clause is not violated.

Finally, it should be pointed out that the Commonwealth of Puerto Rico has an inherent power to exercise its powers of taxation, which includes the authority to choose subjects and objects of taxation, and to decide which ones shall be tax-exempt. *R.C.A. v. Gobierno de la Capital,* 91 D.P.R. 416, 428 (1964). In the case cited we stated the following:

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[15] The cases in which some state taxation has been revoked because of conflicts with federal laws or regulations involved much more direct language on the part of Congress than in the instant case. *See Arizona Public Service Co. v. Snead,* 441 U.S. 141 (1979), *Maryland v. Louisiana,* 451 U.S. 725 (1981); *Exxon Corp. v. Eagerton,* 462 U.S. 176 (1983); *Pittman v. Home Owners' Loan Corp.,* 308 U.S. 21 (1939), among others.

> The Constitution provides in Art. IV, § 2, that the power of the Commonwealth of Puerto Rico to impose and collect taxes and to authorize their imposition and collection by municipalities shall be exercised as determined by the Legislative Assembly, and it shall never be surrendered or suspended. This Court cannot be inclined to surrender it easily, and it would render it void only when exercised in violation of the applicable provisions of the Constitution of the Commonwealth, or of the private rights guaranteed by the Constitution—no person shall be deprived of his liberty or property without due process of law, nor shall the equal protection of the law be denied to anyone—or if exercised in violation of the lawful and moral obligations which the people accepted in their Federal Relations.

In the instant case, surrendering the power of taxation of the Commonwealth of Puerto Rico is unwarranted, since no conflict exists with the federal statute which exempted this item from federal taxation, nor is the purpose thereof hindered.

WHEREFORE, we concur with the Court and affirm the appealed judgment.

(signature)

FEDERICO HERNANDEZ DENTON

Associate Justice

Terminological Note

1. "Poder federal" is here translated as "federal authority". "Poder" generally means "branch" (of government), which is inapplicable in this context; and one can hardly speak of federal "power" (in legal contexts, at any rate). —Translator

APPENDIX B

IN THE SUPERIOR COURT OF PUERTO RICO
SAN JUAN PART

Civil No. KC089-0016 (904)

Matter: Class Action for Income Tax Refund, etc.

MYRNA RODRIGUEZ, ETC.,
Plaintiff

vs.

SECRETARY OF THE TREASURY,
Defendants

JUDGMENT

(Entered December 17, 1992)

I. *BRIEF ACCOUNT OF THE FACTS*

The plaintiffs are federal employees in the civil service. As part of their compensation, they receive an additional payment as a "Cost of Living Allowance", hereinafter "COLA", 5 USC Sec. 5941. The defendant, the Secretary of the Treasury of Puerto Rico, levies taxes upon "COLA" earned. To simplify the collection of those taxes, the Treasury Department of Puerto Rico, entered into an agreement with the Federal Treasury Department for the withholding of local taxes.[1]

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[1] *Pedro Romero, et al. v. Nicholas F. Brady, et al.*, 764 F. Supl. (sic) 227 (D. Puerto Rico 1991).

In 1987, some of the above plaintiffs came before federal court [2] requesting the refund of income taxes related to COLA. That court dismissed the action filed. The judgment stated verbatim:

> "Our decision to refrain from entertaining this case reflects the longheld principle of federal non-interference with state tax systems if the taxpayer has an adequate remedy in state court. In *Pérez* v. *Ledesma,* 401 US 82 (1971) the Supreme Court explains:
>
> If Federal declaratory relief were available to test state tax assessments, state tax administration might be thrown into disarray and taxpayers might escape the ordinary procedural requirements imposed by state law. During the pendency of the federal suit the collection of revenue under the challenged law might be obstructed, with consequent damage to the state's budget, and perhaps a shift to the state of the risk of taxpayer insolvency. More over (sic), federal constitutional issues are likely to turn on questions of state tax law, which, like issues of state regulatory law, are more properly heard in the state courts.
>
> These same reasons require us not to interfere with Puerto Rico's taxation scheme. We believe the Puerto Rican remedy satisfies the rather minimal procedural requirement of the Tax Injunction Act.
>
> Lastly, plaintiffs claim that this case should remain here because of the important United States Government interest at stake. They believe their interest (sic) are 'inextricably wrapped up' with those of the United States because 'Puerto Rico's taxation of COLA impermissibly interferes with the purposes of the U.S. Congress in establishing the

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[2] *Eugene Parker* v. *Agosto Alicea,* Civil No. 87-0386 (DC, Puerto Rico).

COLA program and make COLA tax exempt. If the tax is not overturned, the United States suffers injury along with its employees because of the impact of the tax on the government's personnel management program and because of its liability for additional COLA to offset the tax'.

. . .

A debatable implication from a federal tax statute cannot be deemed to reflect the United State's interest necesary to permit plaintiff to remain here'. Clearly, this is a far cry from the national interest at stake in *Arlington County*. There is not a clearly established national interest embodied in specific congressional legislation exempting COLA from Puerto Rican taxes. Plaintiffs' cause cannot be equated to a United States cause". (Our emphasis and quotes omitted).

And further it expressed the following:

"Plaintiffs here stand in the same position of the associations. The United States has not consented to being joined as plaintiff. It has not sided with plaintiff's in their challenge to the Puerto Rican taxation of COLA. As a matter of fact, plaintiffs have made the United States a codefendant in this action. They are not 'asserting the same claims as the United States'. 'This, in turn, serves to coordinate our belief that the United States does not and cannot have, as plaintiffs allege, an interest in having a COLA free from Pureto Rico taxes'. The United States have not come forward to defend an alleged national interest as it did in *Arlington County* and *Lewisburg*". (Our emphasis).

This decision was affirmed in its entirety by the Federal Court of Appeals for the First Circuit. *Eugene Parker* v. *Agosto Alicea*, 878 F. 2d 557 (1989). In sum, that Court dismissed the action filed by the above plaintiffs

for lack of jurisdiction and held that the appropriate instance to litigate their claims was Commonwealth Court.

In view of this ruling, the above plaintiffs filed a complaint before this Court demanding among other remedies, the refund of the taxes paid upon COLA.

After a number of mandatory procedures the defendant, the Secretary of the Treasury of Puerto Rico, requested of us in a motion to that effect that we dispose summarily of the above case.

The above plaintiffs opposed that request, and asked that the case be disposed summarily in their favor.

II. *ISSUES TO BE DECIDED:*

(a) Whether COLA is taxable in Puerto Rico;

(b) Whether the Government of the United States of North America consented to the Government of Puerto Rico to imposing taxes on COLA.

(c) If the above matters are decided in the affirmative, then it must also be decided whether the alleged discrimination in favor of the group which impede the tax imposition to the plaintiffs, (federal employees in the civil service).

III. *ANALYSIS OF AND RULING OF THE CLAIMS:*

Article VI, Section 2, of our Constitution provides in its pertinent part:

> "The power of the Commonwealth to impose and collect taxes and authorize their imposition and collection by the municipalities shall be enforced *according to dispositions of the Legislative Assembly*, and it shall never be surrender or detained. . ."

The ample discretion the Legislative Assembly possesses in the tax field has long been recognized. Traditionally, the classification has been a method for adjust-

ing the tax programs to local uses and needs with the purpose of attaining a fair distribution of the tax burden. *US Brewers Assoc.* v. *Srio. de Hacienda,* 109 DPR 456, 459-460 (1980).

In *RCA* v. *Gobierno de la Capital,* 91 DPR 416, 428-429 (1964). Our Supreme Court expressed the following:

> ". . . the public and governmental powers of the Commonwealth of Puerto Rico on the authority it wields exclusively, and the most fundamental among them to impose taxes essential to its own creation as a political State and essential to its subsistence and for the continuance of the State, issue from it itself and from its own authority, and as its authority is exclusively its own regarding the power to tax, it exercises this power free from higher authority, subject only to the limitations of its own Constitution and its Bill of Rights, which Congress has already determined is not contrary to the applicable provisions of the Constitution of the United States, and to those obligations the people assumed when accepting the federal regulations which would exist and may exist with the United States pursuant to Act 600. . . .".

Pursuant to such constitutional mandate the Income Tax Act of Puerto Rico was enacted, 13 LPRA 3001 et. seq., as amended. Among the provisions of this law there is one which defines which income shall be subject to tax:

> Gross Income:
>
> "(a) General Definition.—'Gross Income' includes revenues, benefits and income derived from salaries, wages or compensation for personal services (including the compensation earned by employees or officials of the Commonwealth of Puerto Rico, of any state of the Union of the United States, or any political subdivision thereof, or any agency or instru-

> mentality of any of the entities mentioned) of any kind and whichever form they are paid; or from professions, trades, businesses, commerce or sales; or from property operation; also those deriving from interests, rents, dividends, company profits, securities or from the operation of any business conducted for profit or utility; and earnings or profits and income derived from any source." (Our emphasis)

We immediately note that the definition of gross income is broad, that is, it includes any remuneration, no matter what the parties call it or whether it is effected in money or not. For example, it is understood from the definition of "wages" given by the law, 13 LPRA 3141 (a)(1):

> "(1) Salaries—The term "salary" means all revenues for services rendered by an employee to its employer, and all revenues for pensions for services rendered including the money value of all revenue paid through any means other than money; . . ." (Our emphasis).

Among the exclusions of gross income enumerated in the Act, 13 LPRA 3022(b), salary differentials and concessions of similar nature are not included. We shall remember that in Puerto Rico in this field the maxim "expresio (sic) unius est exclusivo alterius" governs. That is, if the law does not expressly establish that a certain income is exempt from taxation, it is understood that it is taxable, *Berwind Lines, Inc.* v. *Secretario de Hacienda,* 113 DPR 658, 660 (1982).

The interpretations of the Department of the Treasury of Puerto Rico have always be to the effect that COLA constitutes income subject to taxation. For example, in 1973, severally federal employees asked the then Secretary of the Treasury, Salvador E. Casellas, to clarify for them whether COLA was part of the gross income or not. He

answered with legal grounds that COLA was part of gross income subject to taxation in Puerto Rico.[3]

On October 6, 1976, the Secretary of the Treasury, Salvador E. Casellas, again reaffirmed his position regarding the taxability of COLA in Puerto Rico. This time it was upon the request of Mr. Joseph A. Frangie, President of the American Federation of Federal Government Employees, who through the former Resident Commissioner Jaime Benítez, asked the Secretary of the Treasury to express itself on the matter. In this letter, the Secretary of the Treasury stressed the following:

> "This Department recognizes the grounds alleged by Mr. Frangie. However, we believe that any measure in this sense may be discriminatory against other employees of other employers who earn similar compensation to those mentioned above and must include them in their gross income." (Our emphasis)

At the end of the year 1979, the then Secretary of the Treasury of Puerto Rico, Julio César Pérez, at the request of the Governor of Puerto Rico, Carlos Romero Barceló, reaffirmed the position that COLA was taxable in Puerto Rico. This missive was the product of a demand made to the Governor by Mr. Francisco Fraguada Saldaña (a federal employee). On doing so, the Secretary of the Treasury stated in pertinent part:

> "If the differential mentioned, which only "white collar" employees receive (General Schedule Employees), were exempted from taxation, we would be granting a tax privilege in favor of a specific group of taxpayers. Thus other groups, whether governmental or private business employees who earn taxable incomes as a result of the differential mentioned, would request the same tax treatment. Therefore,

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[3] As it appears, without any controversy, in documents submitted to this Court before the present judgment and which is part of the record.

the tax impact of any measure with similar intentions might result in a substantial lessening of the Commonwealth's revenues." (Our emphasis)

On April 13, 1985, the law firm Oitzinger & Mullendore, on behalf of a group of Federal Government employees, sent a letter to the Department of the Treasury requesting the refund of taxes collected on COLA from those employees.

On September 18, 1985, a memorandum signed, among others, by Mr. William Stuart Collazo, acting as Chief of the Administrative Appeals and Counseling Office of the Department of the Treasury, was sent to the Director of the Income Tax Bureau. This memorandum stated once again that COLA was part of taxable income in Puerto Rico.

On September 27, 1985, the Director of the Bureau of Income Tax of the Treasury Department of Puerto Rico, Mr. Arcángel Cáceres Carlo, answered the letter previously sent by the Mullendore law firm informing him that the COLA must be included as income subject to taxation in Puerto Rico.

Regarding the above, this Court understands that COLA is subject to taxation in Puerto Rico.

Now we shall rule on whether federal law permits Puerto Rico to impose taxes upon COLA.

The doctrine of intergovernmental tax immunity was developed to protect the federal government from tax barriers raised by various states of the Nation which grow and to stabilize as a government independent hampered its growth and stability independent of the states.[4] However, such doctrine developed in favor of the states, as the Federal Government attained stability as an entity independent of the various states; the pertinent case law

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[4] Hartman, *Federal Limitations on State and Local Taxation*, section 6:1; *McCulloch* v. *Maryland*, 17 US 316 (1819).

took care of revoking such protection, *Graves* v. *New York*, 306 US 466 (1939).

At the present time, the doctrine in force to these effects, 4 USC 111, is the following"

> "The United States consents to the taxation of pay or compensation for personal service of an officer or employee of the United States, a territory or possession or political subdivision thereof, the government of the District of Columbia, or an agency or instrumentality of our or more of the foregoing, by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation". (Our emphasis).

In *Baker* v. *Kansas*, 60 LW 4322 (1992), the Supreme Court of the U.S., when discussing the doctrine of intergovernmental immunity, informed us of the following:

> "Our approach to deciding this case is controlled by *Davis*, which invalidated a Michigan Law that imposed taxes on federal civil service retirees' benefits bat not on benefits received by state and local retirees. In reaching that decision, we traced the history, of 4 USC section 111 and concluded that 'the retention of immunity in section 111 is coextensive with the prohibition against discriminatory taxes embodied in the modern constitutional doctrine of intergovernmental tax immunity'. 489 US, at 813. Under that doctrine, we evaluate a state tax that is alleged to discriminate against federal employees in favor of state employees by inquiring 'whether the inconsistent tax treatment is directly related to, and justified by' 'Significant differences between the two classes'. Id., at 816 (quoting *Phillips Chemical Co.* v. *Dumas Independent School Dist.*, 361 US 376, 383 (1960)". (Our emphasis and in the original).

In *Davis* v. *Michigan Dept. of Treasury*, 489 US 803 (1989), the Supreme Court made an extensive analysis

about 4 USC 111, and established the guidelines to be followed in determining if an specific local statute was invalid when in conflict with the discrimination prohibition against federal employees contained in 4 USC 111 and we quote:

> ". . . While Congress could perhaps have used more precise language, the overall meaning of section 111 is unmistakable: it waives whatever immunity past and present federal employees would otherwise enjoy from state taxation of salaries, retirement benefits, and other forms of compensation paid on account of their employment with the federal government, except to the extent that such taxation discriminates on account of the source of the compensation". (Our emphasis)
>
> . . .
>
> "Under our precedents, 'the imposition of a heavier tax burden on those who deal with the sovereign than is imposed on those who deal with other must be justified by difference between the two classes'. *Phillips Chemical Co.* v. *Dumas Independent School Dist.*, 361 US at 383, 4 L ed 384, 80 S Ct. section 474. In determining whether this standard of justification has been met, it is inappropriate to rely solely on the mode of analysis developed in our equal protection cases. We have previously observed that 'our decisions in the equal protection field are not necessarily controlling where problems of intergovernmental tax immunity are involved'; because 'the government's interest must be weighed in the balance'. Id., at 385 4 L ed 2d 384, 80 S Ct. section 474. Instead, the relevant inquiry is whether the inconsistent tax treatment is directly related to, and justified by, 'significant differences between the two classes'. Id., at 383-385, 4 L Ed 2d 384, 80 S Ct. 474". (Our emphasis)

And finally, and in the pertinent part, it held:

> . . . "We have recognized, in cases involving invalid classifications in the distribution of government benefits, that the appropriate remedy 'is a mandate of equal treatment, a result that can be accomplished by withdrawal of benefits from the favored class as well as by extension of benefits to the excluded class'. . . ." (Our emphasis on the original and ours, omitted quotes).

In sum, a state, territory or political subdivision thereof may impose taxes on pay or compensation received by a federal employee, provided it does not discriminate by source of the income. And provided no federal statute exists which expressly those from taxes levied by such entities.

We have carefully examined the provisions related to COLA, and nowhere does it appear that Federal Congress has granted it immunity from state or territorial taxes.[5] 26 USC 912. The more so in light of the judgment in *Davis*, supra.[6]

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[5] The same finding was made in *Lapin* v. *US*, 617, F. Supp. 167 (DCDC 1985), and we quote:

> "Plaintiff contends, however, that the COLA is not income within the meaning of section 265(1) because it is noncompensatory in character. Plaintiff relies principally on a senate report concerning the exemption from federal income tax of certain COLA'S granted to federal employees. There is nothing in the report, however, that even suggest that COLA'S are not considered income. Under the Internal Revenue Code, gross income means all income from whatever source derived, unless excluded by law. Treas. Reg. 1.61. The COLA at issue is in this case is a class of income excluded by IRC section 912 from gross income". (Our emphasis and footnote omitted).

[6] *Davis*, supra: "While congress could perhaps have used more precise language, the overall meaning of 4 USC 111 is unmistakable: it waives whatever immunity past and present federal employees would otherwise enjoy from states taxation of salaries, retirement benefits, and other forms of compensation paid on account of their employment with the Federal Government, . . . (Our emphasis).

In this connection we believe that we need not apply the federal supremacy clause, Art. VI, sec. 2, to this case. No specific provision exists, whether express or otherwise, to prevent taxation of COLA by the Government of Puerto Rico.[7]

On the other hand, the above plaintiffs understand that COLA is not covered under the provisions of 4 USC 111, because it is not pay or compensation. We are persuaded by the plaintiffs' contention. A read out of the legislative history of 5 USC 5941 and 26 USC section 912 convinces us that COLA constitutes compensation in addition to the basic pay compensation; let us see:

5 USC 5941, provides the following:

> "(a) Appropriations of Funds available to an Executive agency, except a government controlled corporation, for pay of employees stationed outside the continental United States or in Alaska whose rate of basic pay are fixed by statute, available for allowances to these employees. The allowance is based on:
>
> (1) Living costs substantially higher than in the District of Columbia;
>
> (2) Conditions of environment which differ substantially from conditions of environment in the continental United States and warrant an allowance as a recruitment incentive; or
>
> (3) Both of these factors.
>
> The allowance may not exceed 25 percent of the rate of basic pay. Except as otherwise specifically authorized by statute, the allowance is paid only in accordance with regulations prescribed by the Presi-

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[7] For an extensive discussion of such constitutional clause, see: *Fidelity* v. *De la Cuesta*, 73 L Ed. 2d 664 (1982) and *Tribe, American Constitutional Law*, 2d Ed., Section 5-20: 6-31, Foundation Press, New York (1988).

> dent establishing the rates and defining the area, groups of positions, and classes of employees to which each rate applies". (Our emphasis)

From the above it can clearly be inferred that COLA constitutes pay in addition to the basic pay. One thing is that it means "income", and other if it is subject to taxation or not. Either way speak the commentators in the tax field:

> "Any permanent increment to wealth generally is defined as income. Temporary increments such as loans are not considered to be income. Sometimes income is subject to Federal taxation and other times it is not. The taxability of these increments to wealth generally depends upon whether Congress has exempted a particular form of income from taxation. Increments to wealth take many forms. Such increments may take the form of cash, property other than cash, or even services which are rendered to the taxpayer. As a general rule, Congress, and the various Federal courts assigned to interpret its laws consider any increment to wealth to be taxable income unless it is excluded by definition (e.g. loans that must be repaid), by specific statutory authority in the Internal Revenue Code of 1986, or by the Constitution".

In the footnotes clarifying the principal text of the law creating COLA, 5 USC section 5941, there appears the following:

> "The word 'allowance' is substitute for 'additional compensation' as a more apt term and for consistency."

Finally, let us analyze whether there exist or not a different treatment for other groups to the detriment of the plaintiffs.

The above plaintiffs understand that the Puerto Rico Treasury Department grants preferential treatment to the

members of the National Guard. All because tax is not imposed upon the income they receive for "subsistence allowance" or "quarter allowance".

To support the above, the above plaintiffs attached a copy of a sworn statement executed by Mr. William Stuart Collazo, a former official of the Treasury Department of Puerto Rico. In that statement, Mr. Stuart said the following and we quote:

> "3. That besides the duties of such position by instructions of the Secretary of the Treasury I gave lectures to National Guard, Army and Navy personnel about their tax liability in Puerto Rico. I had been doing it even since I was Director of Administrative Hearings in 1976".
>
> 4. That since that date it was the administrative position of the Treasury Department that the subsistence and quarter allowances items received by that personnel were excluded from taxable income and it was thus explained to them in the lectures mentioned."

On the other hand, the Secretary of the Treasury attached a copy of a sworn statement given by Mr. David Carrión Baralt, and in which he stated the following:

> "3. I am presently employed as a Full Time Judge Advocate of this military corps, I have held this post since 1987.
>
> 4. Among the duties connected with my position is giving legal advice to the Adjutant General's offices, to the members of the General Staff, as well as to the Financing and Pay offices of the National Guard of Puerto Rico.
>
> 5. As far as I can remember, when I started my duties as Full Time Judge Advocate in 1987, in the files of the National Guard Financing

and Pay offices there existed no ruling or administrative decision by the Department of the Treasury establishing any public policy granting tax exemption to the members of the National Guard.

6. During the last few years I have neither received nor know of the National Guard offices having received any ruling or administrative decision by the Department of the Treasury exempting from taxation any income item from the income of the members of that military body". (Our emphasis).

Last 23rd of October, we held a hearing in order for the parties to clarify for us some aspects of this case. At such hearing, we were given the transcript of Mr. William Stuart Collazo's deposition.

We have carefully examined this deposition, and from the transcript the following may be inferred without any doubt at all:

a) The public policy of the Treasury Department of Puerto Rico has always be that COLA is taxable.

b) The members of the armed forces (National Guard) on a full-time basis (permanent) receive COLA. And it is taxable in Puerto Rico.

c) Decisions about taxability of any substantial item were always made in writing.

d) COLA and the subsistence and quarter allowances are not the same thing.

e) Employees of the Federal civil service do not receive subsistence allowance or quarter allowance.

f) Pay checks to the military are issued by the Federal Treasurer.

g) There is no legal provision in Puerto Rico expressly exempting the quarter allowance and subsistence allowance received by the army from taxes.

h) Mr. Pedro Nicot was of Mr. William Stuart Collazo's superior.

i) Mr. William Stuart did not present at his deposition any formal ruling from the Treasury Department of Puerto Rico, exempting from taxes the quarter and subsistence allowance items. What he did present was some handwritten notes written by himself a few years ago.

j) Mr. William Stuart Collazo is a member of the National Guard.

k) The federal employees in the civil service may belong to the National Guard and receive subsistence allowance and quarter allowance.

l) Mr. William Stuart Collazo worked for the Treasury Department of Puerto Rico until 1987.

The above plaintiffs believe that there is a contradiction between what Mr. Stuart said, and the statement of Mr. Carrión Baralt. In this regard they believe that is a factual controversy which bars entering of summary judgment in favor of the Secretary of the Treasury.

On the other hand, the Secretary of the Treasury told us that even if he admitted for the sake of argument that he exempts from taxes the quarter and subsistence allowance items, nevertheless such difference in treatment is warranted because there are substantial differences between those and the employees in the Federal Civil Service. All that, according to the doctrine established in *Davis*, supra.

From a sober reading of Mr. Stuart Collazo and Mr. Carrión Baralt's sworn statements and from the deposition, we rule that there is no conflict between them; let us see:

Mr. William Stuart Collazo said that the administrative position of the Treasury Department was that the sub-

sistence and quarter allowance items do not constitute income subject to taxation.

On the other hand, Mr. Carrión Baralt averred under oath that there does not exist in the National Guard files any ruling or administrative decision by the Treasury Department exempting from taxes the members of the National Guard; and that since 1987, either he has acknowledgment nor has receive any ruling or determination from the Puerto Rico's Treasury Department exempting from tax any item of income of the National Guard members.

In any place mister Carrión Baralt expressed that the Treasury Department assesses taxes to the "quarter allowance" or the "subsistence allowance" items, not either expressed the contrary. Notice, that mister Carrión Baralt is not an official of the Treasury Department of Puerto Rico. He is talking on his official capacity as legal counsel of the National Guard. That is, that as far as he knows in his files do not exist any writing which exempt from income taxes the income of the National Guard members. Neither he knows of any writing or ruling of the Treasury Department exempting from taxation the income items received by the National Guard members.

Nevertheless, regarding mister Stuart Collazo's statements, we note that the same are not sustained by the statements of his deposition. For example, he expressed that the important determinations were always issued in writing. Obviously, to grant an exemption to some items received by the National Guard members is an important determination which require to be issued in writing.

Independent of the previously expressed, it proceeds to grant the summary judgment in the case at bar on the following grounds: *Rodríguez Meléndez* v. *Supermercado Amigo,* 90 JTS 50; *MJCA* v. *Julio E. y Esposa,* 89 JTS 105; *Cuadrado Lugo* v. *Santiago Rodríguez,* 90 JTS 59; *Lloyd's of London* v. *Compañía de Desarrollo Comercial de Puerto Rico,* 90 JTS 606; *Camaleglo* v. *Dorado Wings, Inc.,* 118 DPR 20 (1986).

In the first place, the witness of the plaintiff party, this is, Mr. Stuart Collazo, expressed in his deposition that the military receive COLA and that such COLA is taxable in Puerto Rico.[8] Also, that the COLA received by the military is an additional item and different from the "quarter allowance" and the "subsistence allowance".

Previously, this Court confirmed in front of the parties' legal representations, that the COLA received by the military is taxable in Puerto Rico.[9] Also note, that the federal employees in the civil service do not receive "quarter allowance" or "subsistence allowance". 37 USC 201 et seq.

We find that no discrimination exists in favor of National Guard members. We repeat, with respect to the item of COLA received by members of the National Guard as well as the one received by federal employees in the civil service, the Treasury Department of Puerto Rico assesses taxes. The matter would be different if federal employees in the civil service received quarter allowance and subsistence allowance, and if the Treasury Department assessed taxes on them, but not on the military. That is not the case here.

In the second place, and as the Treasury Department of Puerto Rico accepted for the sake of argument, even if we likened COLA to quarter and subsistence allowance the alleged preferential discrimination in favor of National Guard members would be within the boundaries set by *Davis,* supra. There are significant differences between National Guard members and Federal employees in the civil service. For example, quarter allowance is granted when a member of the armed forces is assigned to a base

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[8] See Minute of September 17, 1991.

[9] See, also, copy of the notes taken by mister Stuart Collazo accompanying the transcript of the deposition. Besides that, it is just necessary a plain reading of 5 USC 5941 and 37 USC 401-402, to note that they are not the same thing. For purposes of 4 USC III. We cannot compare totally different items, but similar.

without housing facilities. All that in order to have personnel available for the defense of national security.

> "The purpose of the basic allowance authorized by this section is to reimburse a service member for personal expenses incurred in acquiring non-governmental housing when rent-free government quarters adequate for himself, and his dependents, are not furnished". 1981, 60 Op. Com. Gen. 154.

Furthermore, federal employees in the civil service are not subject to the rigors of military service. It is well-known that the military are governed by a code of discipline which demands great sacrifices from them.

In the third place, this Court believes that the prohibition provided in 4 USC III and the interpretative jurisprudence regarding that section only apply when are granted benefits to state employees, and they are not granted to federal employees. As the Secretary of the Treasury asserted, members of the National Guard of Puerto Rico receive their pay from the Federal Government except in extraordinary circumstances. That implies that for all purposes National Guard members are federal employees, in addition to federal employees in the federal civil service.[10] In this respect, we cannot apply the doctrine established in *Davis,* supra. The argument would be reduced to one of equal protection of the laws guaranteed by our Constitution and the U.S. Constitution. However, even under the equal protection clause plaintiffs are not entitled to any remedy. *M. & BS, Inc.* v. *Departamento de Agricultura,* 118 DPR 319 (1987); *Coca Cola Bottling Co.* v. *Secretario de Hacienda,* 112 DPR 707, 710 (1982).[11]

In the fourth place, and in addition to the above the fact that if we likened COLA to salary differentials

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[10] In this connection, see for example: *Swanson* v. *Powers,* section 937 F. 2d section 9[illegible]5, 972-973 (4th Cir. 1991).

[11] The doctrine of judicial restraint makes unnecessary such analysis. *ELA* v. *Aguayo,* 80 DPR 552, 559 (1958).

earned by Commonwealth employees, the Puerto Rico Government levies taxes on them both. 13 LPRA 3022(a). That means that there is no unequal treatment between state employees and plaintiffs.

In the fifth place, even assuming as true that the personnel of the Treasury Department of Puerto Rico advises National Guard members to the effect that their quarter allowance and subsistence allowance were exempt from taxation, no right is thereby granted. We repeat that tax exemptions derogations (sic)* of sovereign power, they should not extend further than the express and exact terms contained in the statute granting them and any doubt must lead to a ruling against the existence of the exemption. *Berwind Lines, Inc.* v. *Scrio. de Hacienda,* 113 DPR 658, 660 (1982). We likewise recall that administrative errors give no basis to any rights. *Del Rey* v. *Junta*, 107 DPR 348, (1977). The plaintiffs cannot rely on such wrong administrative practice, (should one exist) to demand equal treatment. That is, if that is occurring, then plaintiffs want to be in the same situation of illegality.

Finally, the plaintiffs allege that the Treasury Department of Puerto Rico discriminates against them, because it supposedly audits and classifies them constantly for investigation purposes. The Treasury Department must institute a plan of operations, since the government has the duty to establish proper mechanisms to enforce tax liabilities. All that within a margin (sic) of constitutional guarantees. In this case claims of violation of civil rights and equal protection lack merit; they constitute mere allegations. *Ariela* v. *Reece*, 88 JTS 103.[12]

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* In the original "derogaciones". Corrector.

[12] For example, see ("Important and Urgent Motion about Discrimination against Federal Employees' COLA and in favor of the National Guard and Reserve under Section 912 and the Supremacy Clause of the Constitution of the United States and Contrary to the

Regarding the above grounds, we DENY the complaint filed by the above plaintiffs and the motion for summary judgment filed by them, and we hereby GRANT the motion for summary judgment filed by the Secretary of the Treasury of Puerto Rico.

This judgment includes and affects:

> "All persons employed within the Commonwealth of Puerto Rico at any time on or after January 10, 1979, by the United States or an agency, establishment, or instrumentality thereof, or a corporation owned by the United States including but not limited to the United States Postal Service, who are or were entitled to receive a cost-of-living allowance, or a like payment as part of basic pay, by or in accordance with 5 U.S.C. section 5941.201-.213, and/or Executive Order 10,000, as amended, or pursuant to another statute, regulation, administrative practice or contract".

RECORD AND NOTIFY.

In San Juan, Puerto Rico, this 17th day of December, 1992.

(Signed)
GILBERTO GIERBOLINI
Superior Court Judge

'Public Tax Salary Act' ") filed by the plaintiffs. Some arguments were made therein but they were never proved with pertinent evidence. Note that the motion is dated January 10, 1992.

APPENDIX C

IN THE SUPREME COURT OF PUERTO RICO

No. CE-93-14

Certiorari invoked as an appeal

MYRNA RODRIGUEZ, JUAN E. LUGO, *et al.*,
Plaintiffs-Petitioners,

v.

SECRETARY OF THE TREASURY, *et al.*,
Defendants-Respondents.

JUDGMENT

San Juan, Puerto Rico, today March 1, 1994

On the grounds set forth in the preceding Opinion, which is made an integral part hereof, the judgment of the Superior Court, San Juan Part is affirmed.

It is pronounced and ordered by the Court and certified by the Clerk. Associate Justice Hernández Denton issued a Concurring and Acquiescent Opinion which Associate Justice Naveira de Rodón joined. Associate Justice Rebollo López did not take part.

(signature)

FRANCISCO R. AGRAIT LLADO
Clerk

APPENDIX D

U.S. CONST. art VI. cl. 2

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

4 U.S.C. § 111 (1988)

§ 111. Same; taxation affecting Federal employees; income tax

The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States, a territory or possession or political subdivision thereof, the government of the District of Columbia, or an agency or instrumentality of one or more of the foregoing, by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

5 U.S.C. § 5941 (1988)

§ 5941. Allowances based on living costs and conditions of enviromnent; employees stationed outside continental United States or in Alaska

(a) Appropriations or funds available to an Executive agency, except a Government controlled corporation, for pay of employees stationed outside the continental United States or in Alaska whose rates of basic pay are fixed by statute, are available for allowances to these employees. The allowance is based on—

(1) living costs substantially higher than in the District of Columbia;

(2) conditions of environment which differ substantially from conditions of environment in the con-

tinental United States and warrant an allowance as a recruitment incentive; or

(3) both of these factors.

The allowance may not exceed 25 percent of the rate of basic pay. Except as otherwise specifically authorized by statute, the allowance is paid only in accordance with regulations prescribed by the President establishing the rates and defining the area, groups of positions, and classes of employees to which each rate applies.

(b) An employee entitled to a cost-of-living allowance under section 5924 of this title may not be paid an allowance under subsection (a) of this section based on living costs substantially higher than in the District of Columbia.

26 U.S.C. § 912(2) (1988)

§ 912. Exemption for certain allowances

The following items shall not be included in gross income, and shall be exempt from taxation under this subtitle;

* * * *

(2) Cost-of-living allowances

In the case of civilian officers or employees of the Government of the United States stationed outside the continental United States (other than Alaska), amounts (other than amounts received under title II of the Overseas Differential and Allowances Act) received as cost-of-living allowances in accordance with regulations approved by the President (or in the case of judicial officers or employees of the United States, in accordance with rules similar to such regulations).

* * * *

P.R. Laws Ann. tit. 13, § 3022(a) (1954)

Sec. 3022. Gross income—(a) *General Definition.*—"Gross Income" includes gains, profits, and income de-

rived from salaries, wages, or compensation for personal service (including payment for services as an officer or employee of the Commonwealth of Puerto Rico, of any State of the Union, of the United States, or any political subdivision, or any agency or instrumentality of any of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the possession or use of or interest in such property; also from interest, rent, dividends, partnership profits, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.